NatWest

Retail and Leisure Outlook report 2023

Tomorrow Begins Today

Contents

Foreword

Despite the challenging outlook, this report highlights key opportunities for retail and leisure businesses, alongside critical insight to help organisations better navigate the headwinds.

Reflecting on the beginning of 2022, a much-needed sense of optimism was rekindled as pandemic disruptions began to subside. Despite unprecedented challenges, the economy performed stronger than anticipated.

The labour market remained robust, economic growth rebounded sharply and global supply chains gradually improved. This optimism proved to be short-lived however, and it feels like a long time since we have operated in any sort of normality.

The Russia-Ukraine conflict injected significant geopolitical instability across Europe, unseen in decades. Shockwaves reverberated throughout the global economy with European energy markets exposed to significant price hikes, while certain food commodities such as wheat rose aggressively as business confidence faltered.

A sharp rise in energy costs ensued, sparking a cost-of-living crisis throughout Europe. UK inflation rose to a 41-year high of 11.1% in October 2022 as the cost of heating, food and transport spiralled. Meanwhile, a volatile political landscape in the UK exacerbated uncertainty.

Although some confidence appears to have been restored in recent weeks, pressure on profits is expected to remain intense in 2023.

Many shoppers have already adopted recessionary behaviours, cutting back their spending on non-essentials, trading down to cheaper alternatives and cancelling spending altogether.

As market events and volatility continue to take their toll, how could this sector respond to find opportunities and come back stronger? What actions can retailers take now for success this year and beyond?

Retailer and consumer businesses have some of the most talented and resilient people you'll meet. The sector is flexible in dealing with challenges, open to managing changing consumer behaviour and ready to pivot to mitigate risks.

I'm delighted to publish this report in conjunction with Retail Economics for the fifth successive year. Sharing this data and the important lessons we've learned could help businesses leverage opportunities from the continued disruption.

Section one outlines the macroeconomic forces impacting consumer spending. Section two provides in-depth insight into the key trends shaping the UK consumer sector over the year ahead. And the final section identifies five business strategies to help industry professionals survive and thrive in 2023.

David Scott
Head of Consumer Industries, NatWest

Contents

The big picture

A backdrop of ups and downs.

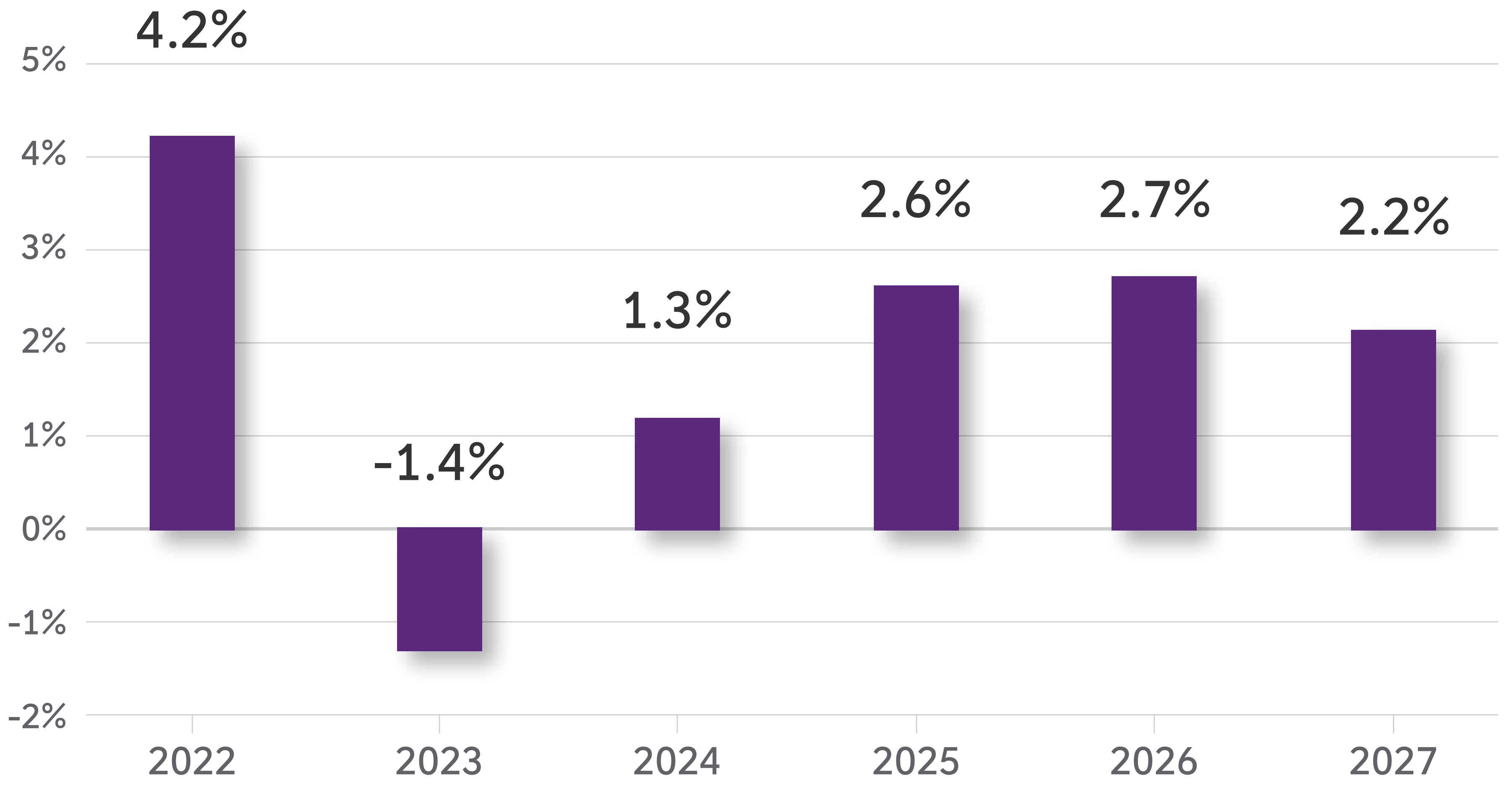
Section one: the big picture.

Early in 2022, national optimism post-Covid was dampened pretty quickly by the escalating Russia-Ukraine conflict, high inflation and tightening monetary and fiscal policy. This materially weakened the outlook for the economy – pressure on personal finances weighed on spending intentions. This section summarises the impacts against this backdrop.

Retail and leisure spending impacted by a deteriorating backdrop in 2023

(1) GDP is projected to contract in 2023, as tighter financial conditions weigh on consumer spending – which accounts for around two-thirds of the economy.

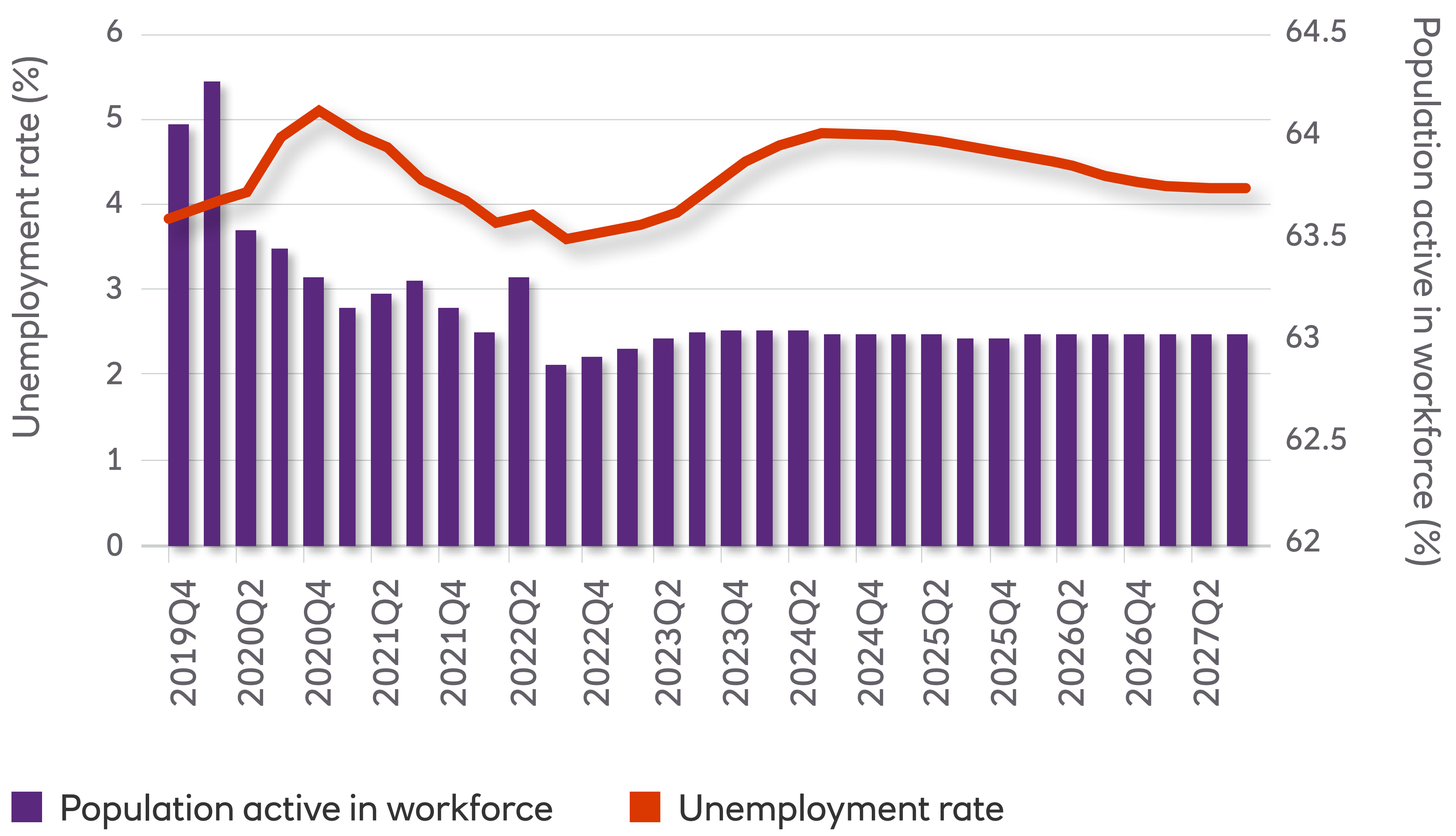
Real GDP growth



Sources: ONS, OBR 2022.

(2) This will see unemployment rise throughout 2023, but labour market participation is set to remain below pre-pandemic rates, impacted by long-term sickness and more students.

Labour market expectations

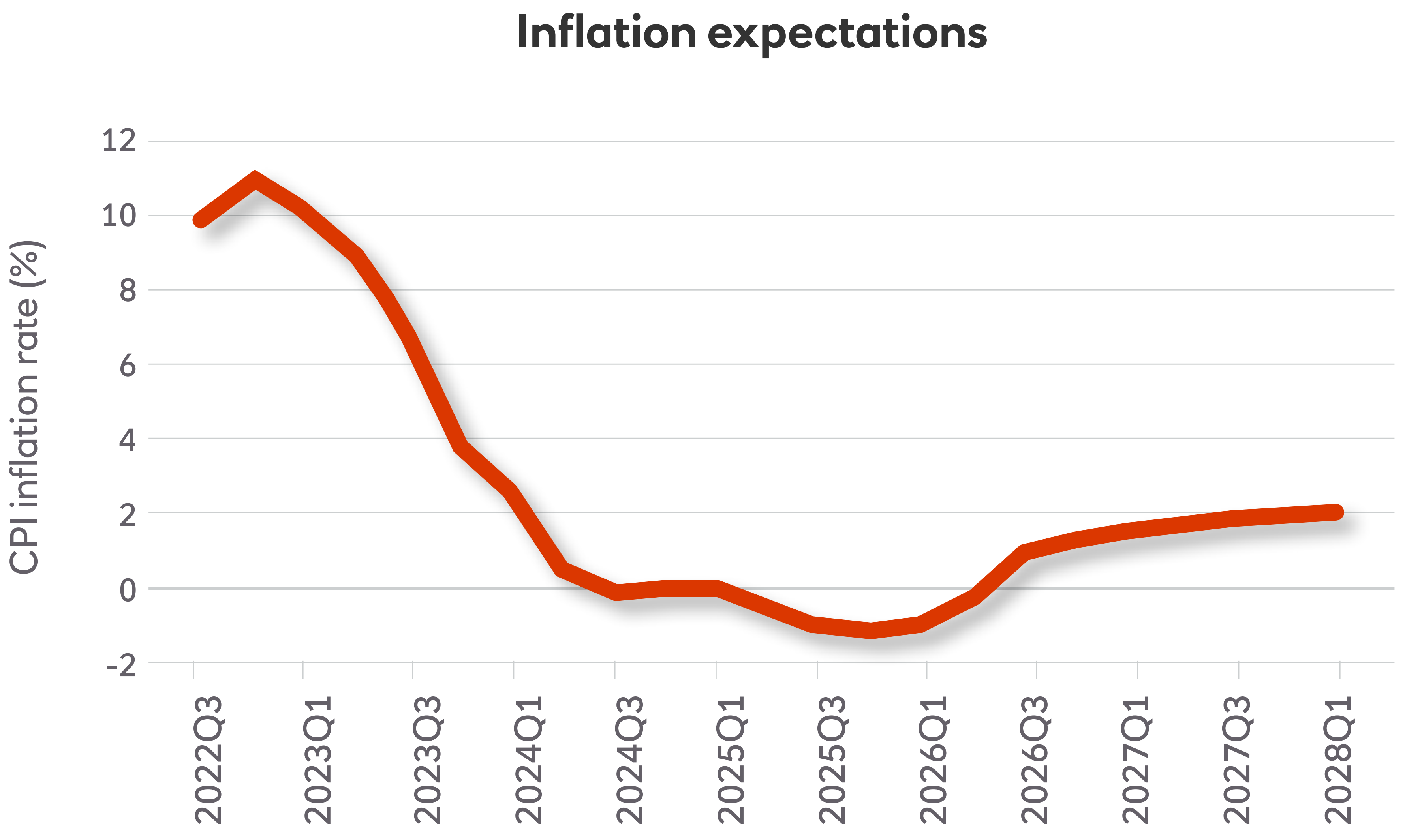


Sources: ONS, OBR 2022.

Contents

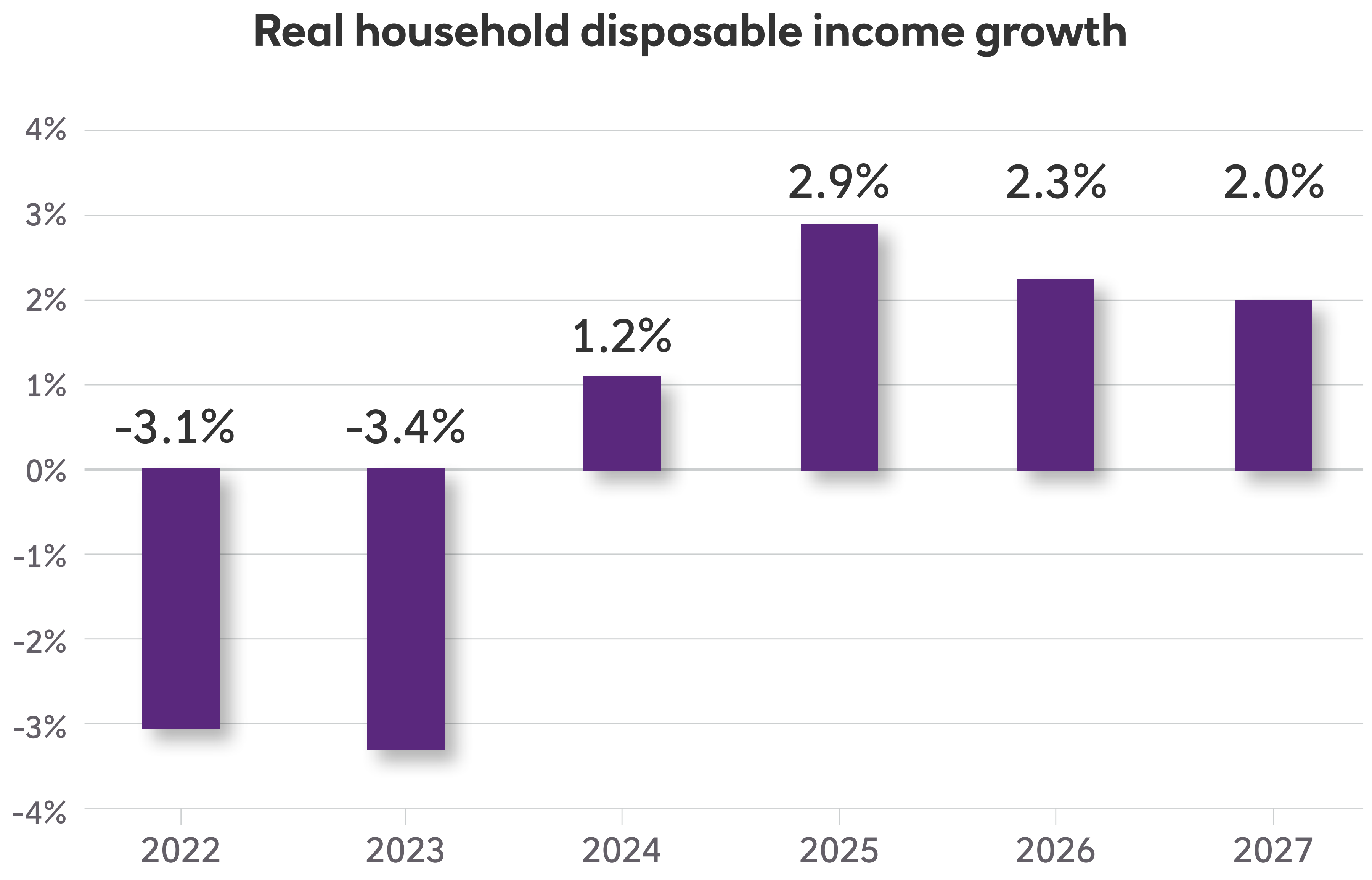
Section one: The big picture.

(3) Escalating energy and commodity prices pushed inflation to a 41-year high of 11.1% in October 2022, but it's expected to fall sharply in 2023, albeit remaining at high levels.



Sources: ONS, OBR 2022.

(4) Double-digit food and energy inflation has hit spending power, with disposable income set to fall further by 3.4% in 2023.



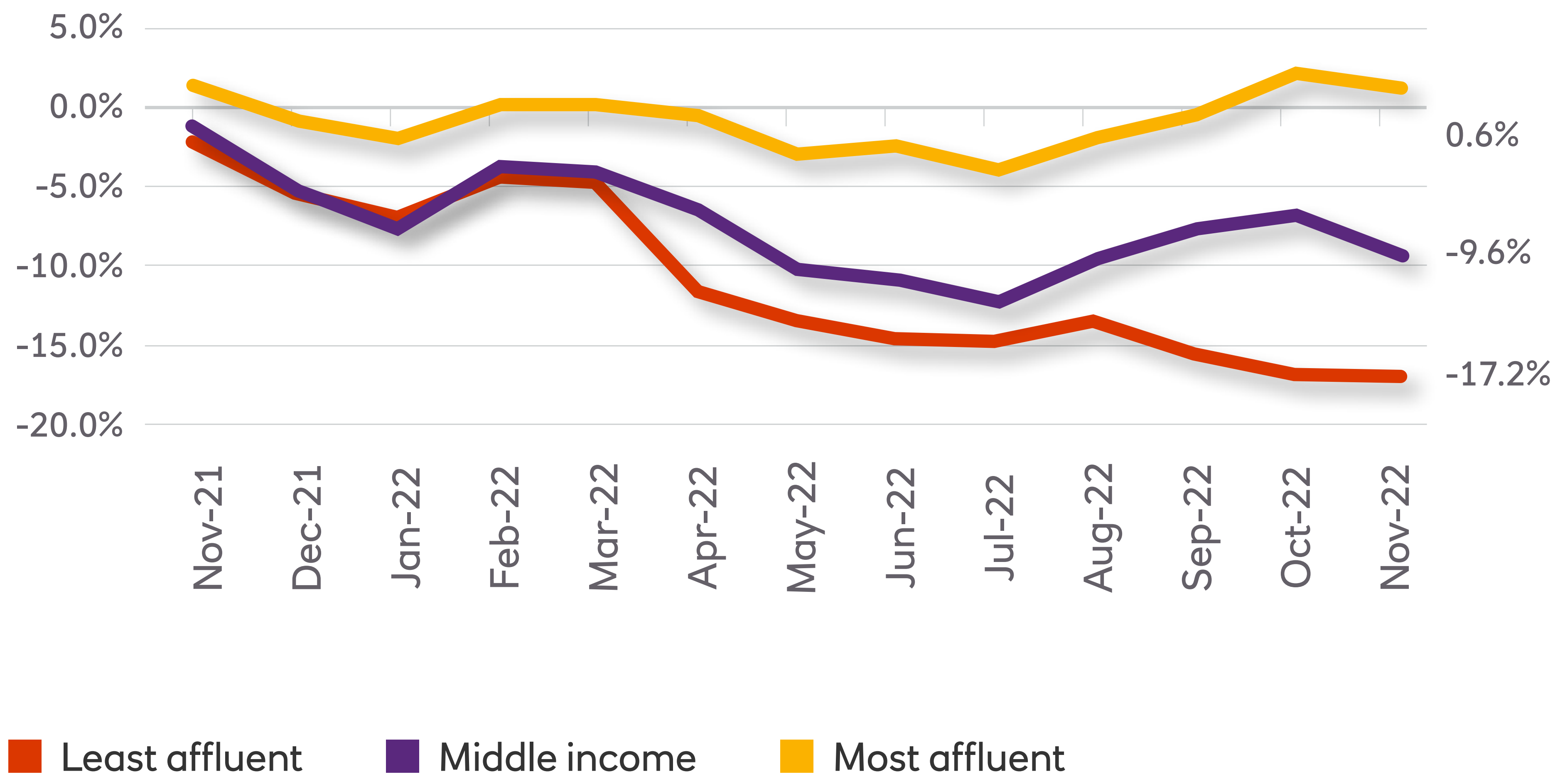
Sources: ONS, OBR 2022.

Contents

Section one: The big picture.

(5) Least-affluent households are hit hardest, given they spend a disproportionate amount of income on essentials.

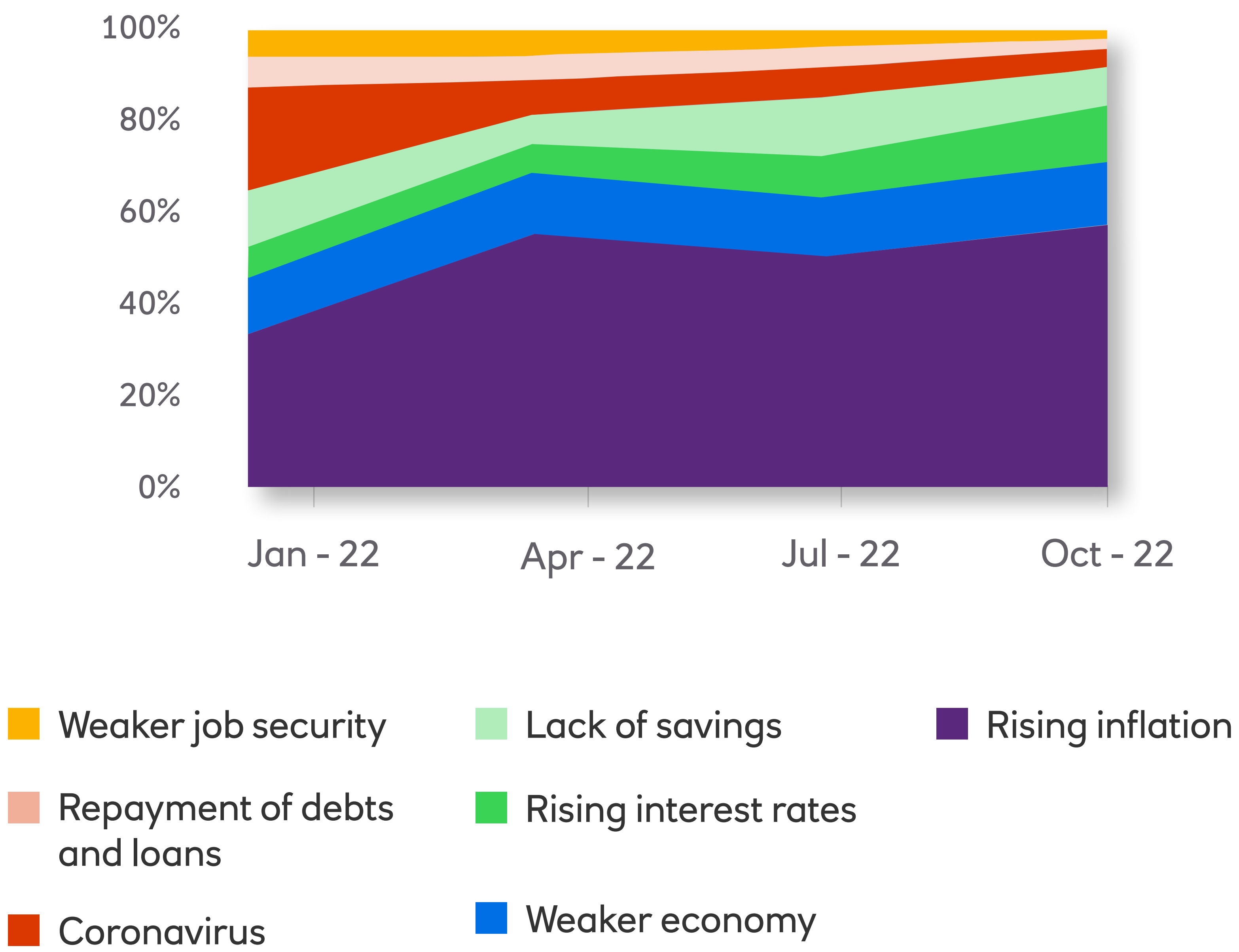
Discretionary income year-on-year change



Source: Retail Economics 2023.

(6) Although inflation is expected to ease in 2023 from recent highs, it remains the greatest concern for consumers.

Currently, which of the following do you find the most concerning?



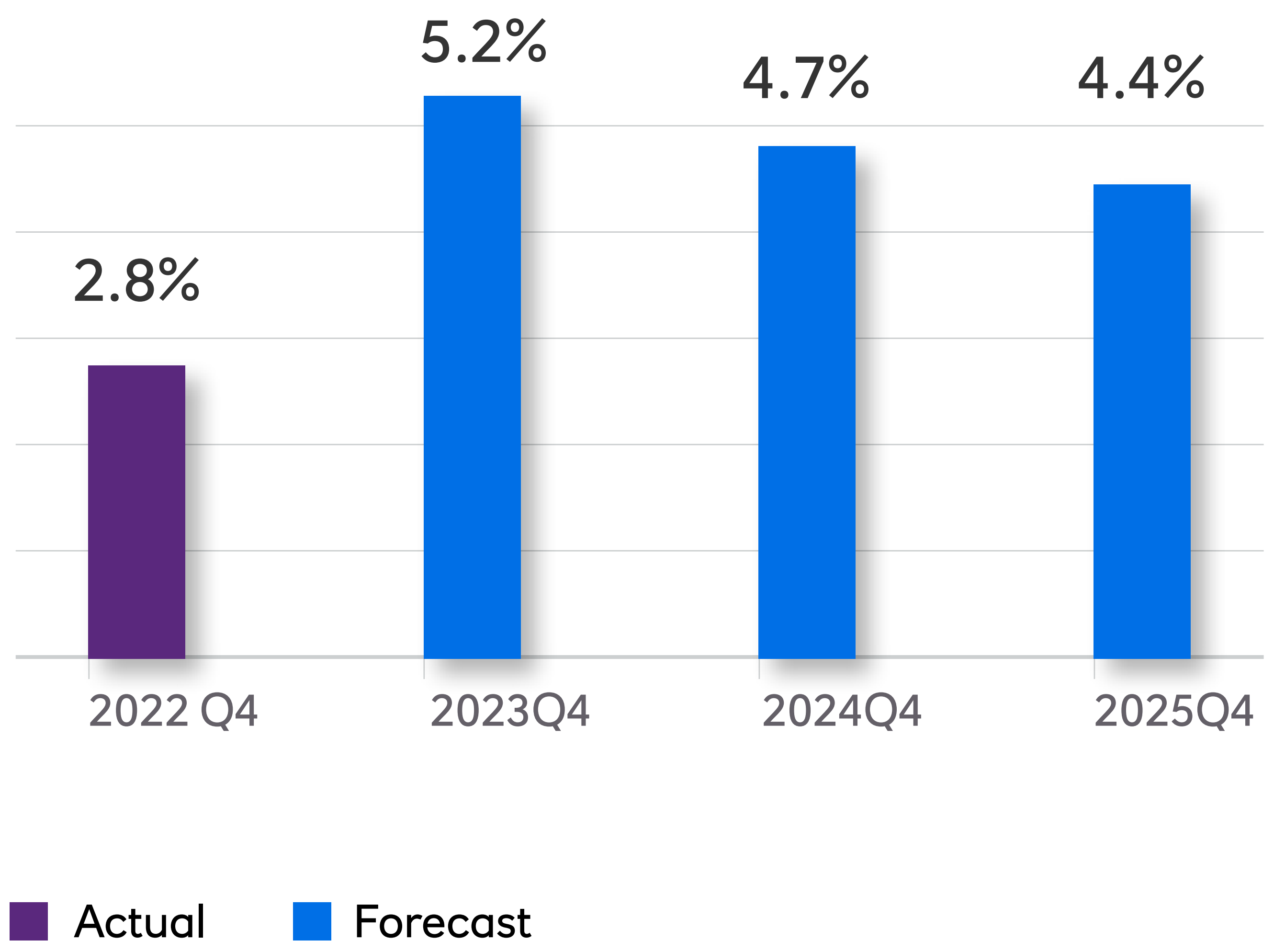
Source: Retail Economics 2023.

Contents

Section one: The big picture.

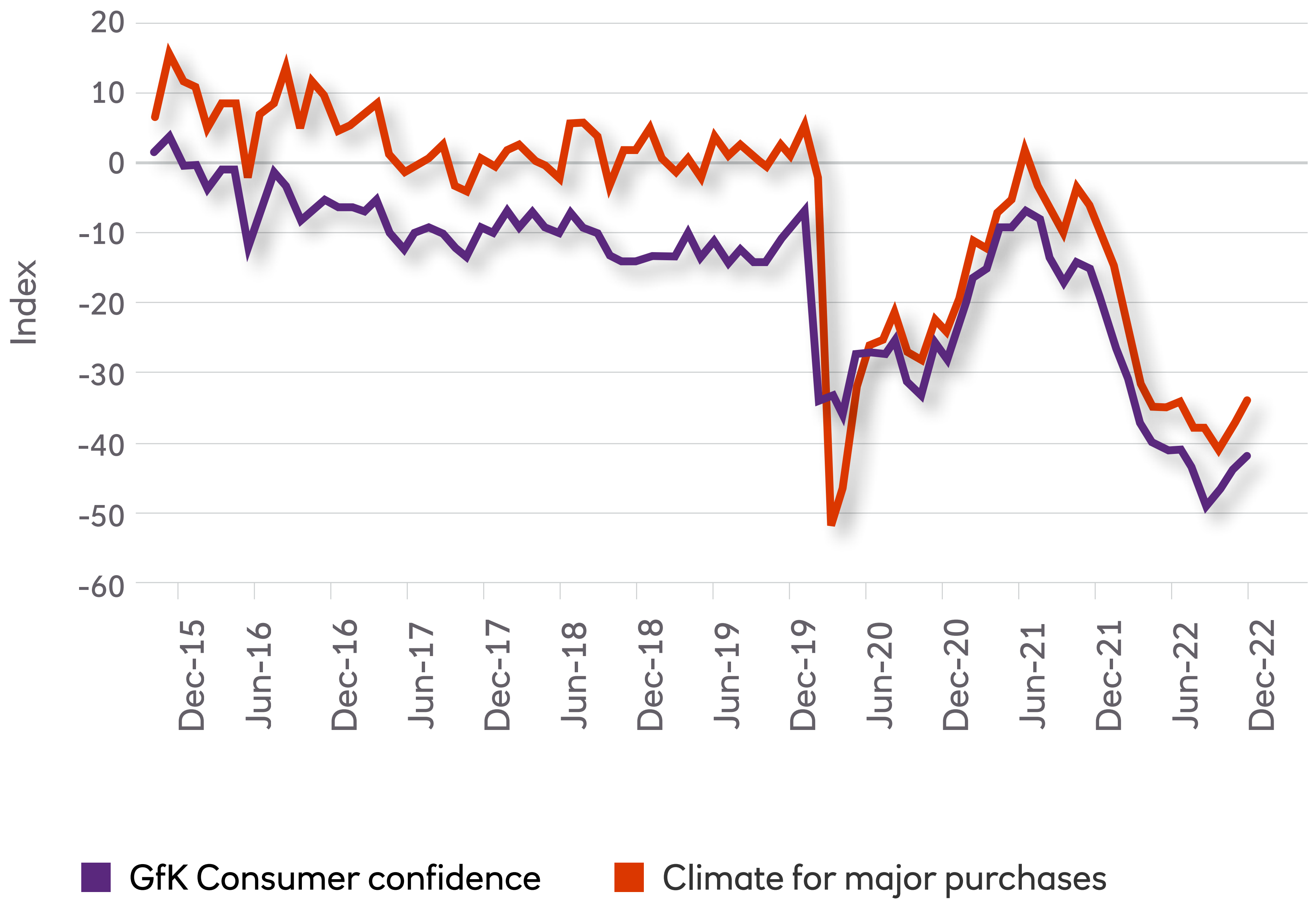
(7) Rising interest rates are also a growing concern, projected to tip 5% in Q4 2023, putting pressure on four million mortgagors in 2023, skewed towards middle and high-affluence households.

Interest rate expectations



Source: Bank of England 2022.

(8) This has seen consumer confidence remain close to record lows and is impacting propensity to spend in 2023, particularly on big-ticket purchases.



Source: GfK 2022.

Contents

Section one: The big picture.

In 2023, the UK's economic downturn is set to be shaped by a number of factors explored in the table shown here. It identifies various downside risks that could prolong a contraction in consumer spending, as well as upside factors that could soften the decline in output.

(9) Summary of key economic risks and opportunities heading into 2023.

Macroeconomic climate

Downside	Upside
Possible recession • GDP forecast to contract 1.4% in 2023 (OBR). • Unemployment forecast to rise to 4.9% in Q3 2024 from lows of 3.5% in 2022 (OBR).	**Softening input costs** • Although historically high, factory gate PPI output inflation eased for a third month to 14.8% year-on-year in October 2022 (ONS).
Household financial pressure • Real household disposable income expected to decline 3.4% in 2023, following decline of 3.1% in 2022 (OBR).	**Inflation eases** • Headline inflation forecast of 3.8% in Q4 2023 (OBR), down from 11.1% peak in October 2022.
Rising interest rates • Bank rate expected to tip 5% in Q4 2023 (Bank of England). • Flows into time deposits (interest-bearing accounts with a specific maturity date) at £11.3bn in October – the highest since records began in 1997 (Bank of England). • Those with debt affected by higher interest rates will experience disproportionate impact on spending power.	**Savings cushion** • Households deposited an additional £6.2bn with banks and building societies in October (Bank of England), providing a financial buffer to the most affluent households.
Housing market slowdown • Rising rates impact 1.7 million on variable rate mortgages and impact two million households looking to remortgage fixed rates in 2023, skewed towards middle and more affluent households. • Softening house prices erode wealth effect.	**Tight labour market** • The most affluent have been able to offset essential price increases through earnings growth (Retail Economics), but puts upward pressure on inflation.
Labour availability • Forecast labour market participation rate of 63% in 2023 (OBR) – below pre-pandemic rate of 64.3% in Q1 2020, impacted by sickness. • Job vacancies remain over one million in late 2022 (ONS).	**Clearer fiscal direction** • Greater political stability with a more hawkish fiscal policy.
War • Russia-Ukraine war expected to persist in 2023, with fears of a renewed Russian offensive in the spring.	**Restrictions unwind overseas** • China is loosening Covid-19 restrictions to improve supply chain flows, benefiting key global shipping routes and manufacturing hubs.
Pandemic resurgence • The possibility still exists for renewed Covid-related restrictions, reflecting global conditions.	

Source: Retail Economics 2023.

Contents

The outlook for 2023

Five key trends to emerge.

Section two: the outlook for 2023.

Our research identifies five key trends that are shaping both the backdrop for consumer spending and the operating environment for businesses in 2023. Each trend draws upon consumer panel data to better understand consumer archetypes and explores the various implications for consumer-facing businesses.

The trends are contextualised by five key themes.

Trend one: recessionary shopping behaviours.
Trend two: polarised spending.
Trend three: stores adopting digital.
Trend four: the future of work.
Trend five: considered and sustainable shopping.

Contents

Section two: the outlook for 2023.

Trend one: recessionary shopping behaviours. Summary | Consumers

- Cost-conscious consumers have emerged, putting pressure on prices.
- Prioritised spending on essentials as the proportion of income spent on food and energy increases.
- 'Nice-to-haves' being delayed as budgets are squeezed.
- Trading down as inflation outpaces earnings.
- Greater price sensitivity is seeing increased use of price comparison and discounts.
- Smaller and stricter basket sizes to manage budgets.

As the UK economy enters what is increasingly looking like a recession, consumers are adapting their behaviour by putting value at the heart of their decision making. The cost-of-living crisis has created different cohorts of price-conscious consumers, reshaping the overall perception of value. Product and service attributes across quality, convenience and experience are in many cases being sacrificed for lower prices as household budgets come under pressure.

Key recessionary behaviours include: trading down to cheaper alternatives; delaying large purchases; focusing on essentials, and discount hunting. All these behaviours have become increasingly important to address within the customer journey, as consumers make more considered purchases.

Delaying spending is the most popular response across consumer-facing categories, as 56.4% of consumers expect their personal finances to weaken over the next year. However, consumer values vary depending on the shopper mission, category and target market. Our research shows significant differences in spending intentions across retail and hospitality categories.

"56.4% of consumers expect weaker personal finances in 2023."

Contents

Section two: the outlook for 2023.

How to read this chart: The bubbles reflect different categories, with orange bubbles representing typically essential spending and purple bubbles being typically non-essential spending. The size of bubble indicates the proportion of consumers disrupting normal spend in that category in 2023.

The X-axis plots the net balance of those intending to spend as normal in the category in 2023 against those who intend to stop almost all spending in the category (with bubbles on the right most at risk of consumers stopping spending).

The Y-axis plots the net balance of those intending to delay spending in a category against those looking to find cheaper alternatives instead (with bubbles above 0 on the Y-axis more at risk of delayed spending).

(**10**) Spending intentions in 2023.

Source: Retail Economics analysis 2023.

Contents

Section two: the outlook for 2023.

Although many factors influence consumer behaviour, the research identifies two key reasons that underpin spending intentions across categories: more income sensitive demand for discretionary categories, and the unwinding of pandemic-fuelled spending.

Firstly, there are clear differences in the propensity to cut back spending across essentials versus non-essentials as incomes are squeezed (highlighted by the orange and purple bubbles in figure 10). Intuitively, spending across essential categories is less likely to be impacted by cutbacks, whereas more discretionary purchases are more susceptible to consumers initially cutting back on, and cutting the deepest. However, given the 'essential' status of many products, consumers will look to substitute with alternatives – rather than go without. This is exemplified by food spending being more defensible than takeaways as consumers look to cut discretionary purchases.

Secondly, the pandemic brought home life into sharp focus. This resulted in behaviours that increased comfort levels of stay-at-home activities such as home improvements, working from home and entertainment. In turn, this brought forward replacement cycles for many big-ticket items within furniture, flooring, DIY, gardening and electricals – all to the detriment of sales in 2023.

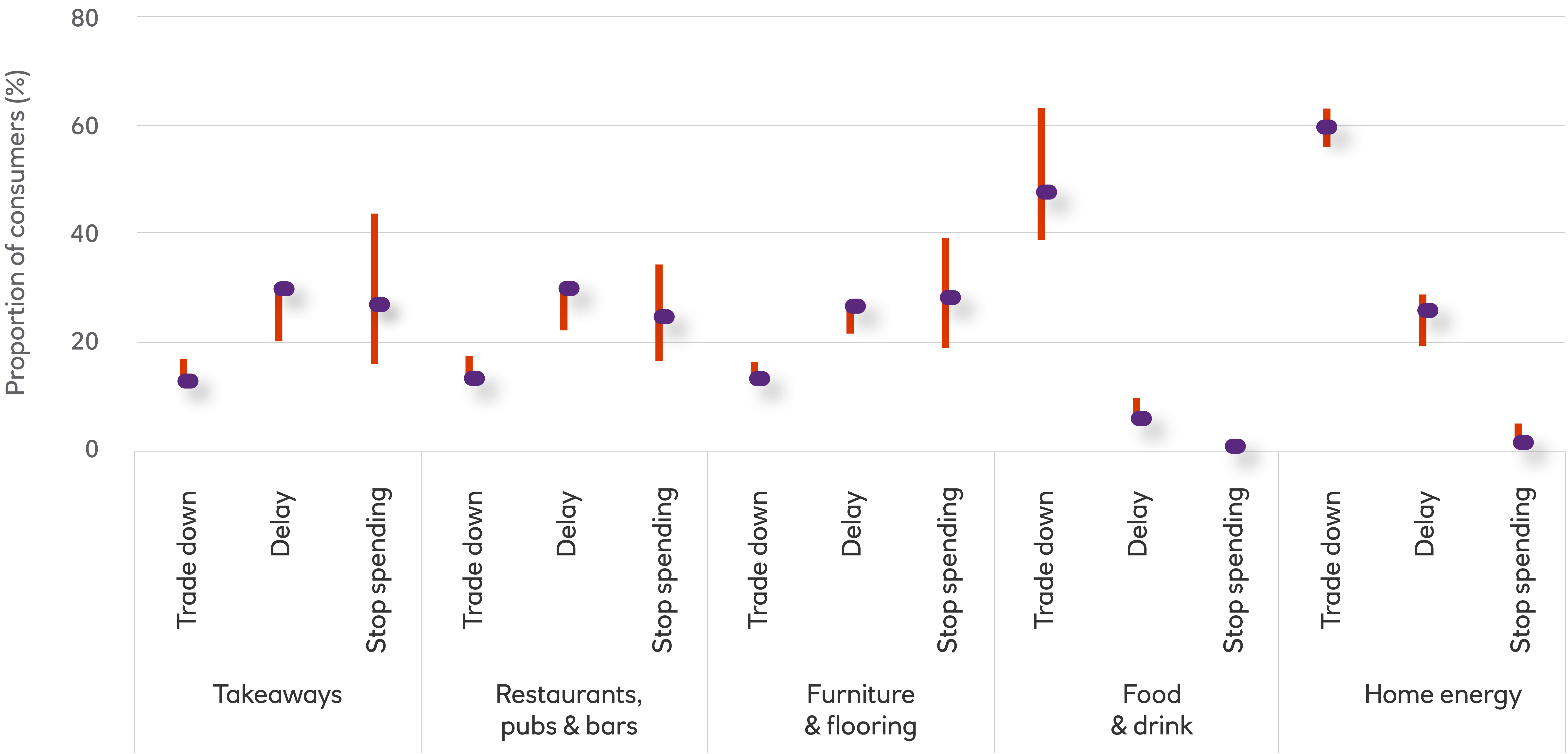
Over a quarter of consumers (28.2%) plan to cut almost all spending on furniture and flooring, followed by takeaways (27%) and homewares (25.5%). Unsurprisingly, these factors impact consumers differently across income groups as energy-driven inflation takes hold, exerting the greatest pressure on the least affluent. This leads to stark differences in spending intentions by household, as detailed in our research.

"28.2% plan to cut almost all spending on furniture and flooring."

Contents

Section two: the outlook for 2023.

(11) Cutback behaviour varies by affluence.



How to read this chart: The X-axis of the chart plots five categories, with each category split by the proportion of consumers either looking to trade down, delay or stop spending. Purple dots plot the average response across all households. Roll over the orange lines to show the range of responses between the least affluent (high points) and most affluent (low points).

Source: Retail Economics 2023.

Contents

Section two: the outlook for 2023.

Home energy is the category least likely to face cutback, given less opportunity for substitution. Interestingly, it faces the lowest variance between the least and most affluent compared with all other categories within the research (supported by government subsidies), although the least affluent are more likely to put off using home energy more than the most affluent.

Food and drink is the least likely category where consumers will delay spending. It ranks a low 14th (out of 18) in likelihood of cutting back spending. Here, consumers are more likely to buy cheaper alternatives, as suggested by a high 48% looking to trade down. This rises to 63% among the least affluent as grocers fiercely battle with price promotions and value alternatives to retain loyalty.

Compared with takeaways and restaurant spending, food is clearly more defensible. The least affluent are more than twice as likely to stop spending across takeaways, restaurants, pubs and bars than the most affluent. This represents one of the key differences compared with other categories.

Similarly, this disparity is seen within the furniture and flooring category. Here, consumers on average are more likely to stop spending than delay or trade down. Also, many purchases were bought forward during Covid-19 restrictions, which has shifted spending priorities on these big-ticket items.

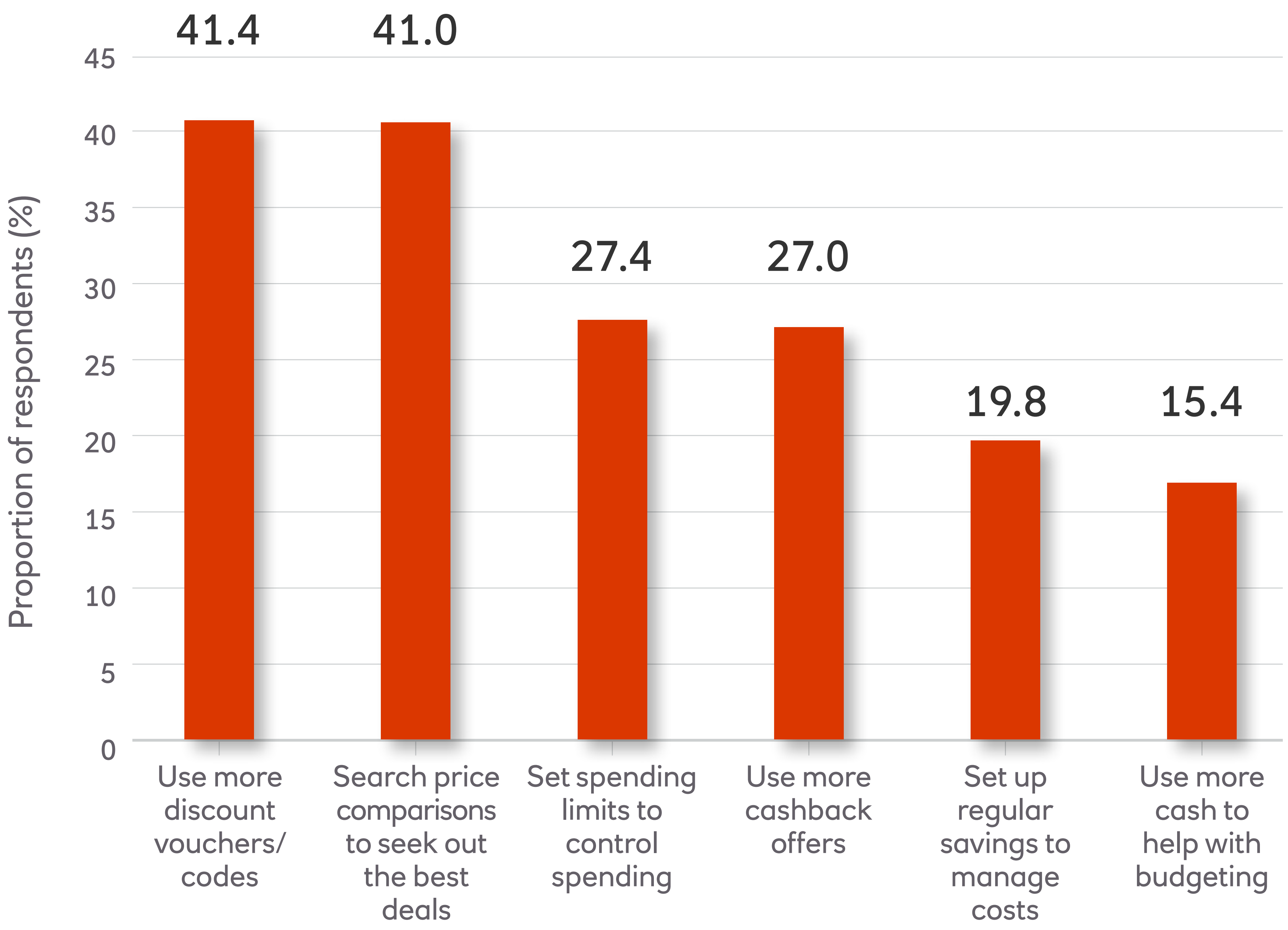
When consumers do look to spend, greater cost consideration is disrupting the typical customer journey. A rise in bargain hunting promotes use of price comparisons and cashback offers, as savvy shoppers set spending limits and use regular savings or cash to better manage budgets.

Contents

Section two: the outlook for 2023.

(12) Households are seeking discounts and comparing prices to control squeezed budgets.

Q: *Do you expect to do any of the following to help improve your money management?*



Source: Retail Economics 2023.

Trend two: polarised spending. Summary | Consumers

- Widening societal divide has been accelerated by the pandemic and cost-of-living crisis across debt, income and savings.
- Financial burdens are engulfing more households as interest rates increase, impacting around four million mortgage holders in 2023, with two million on fixed rates coming to the end of their term – which could see a £8.3bn jump in repayments.

Spending across retail and leisure is expected to become increasingly polarised throughout 2023 as the effects of Covid-19 and the cost-of-living crisis impacts households unevenly.

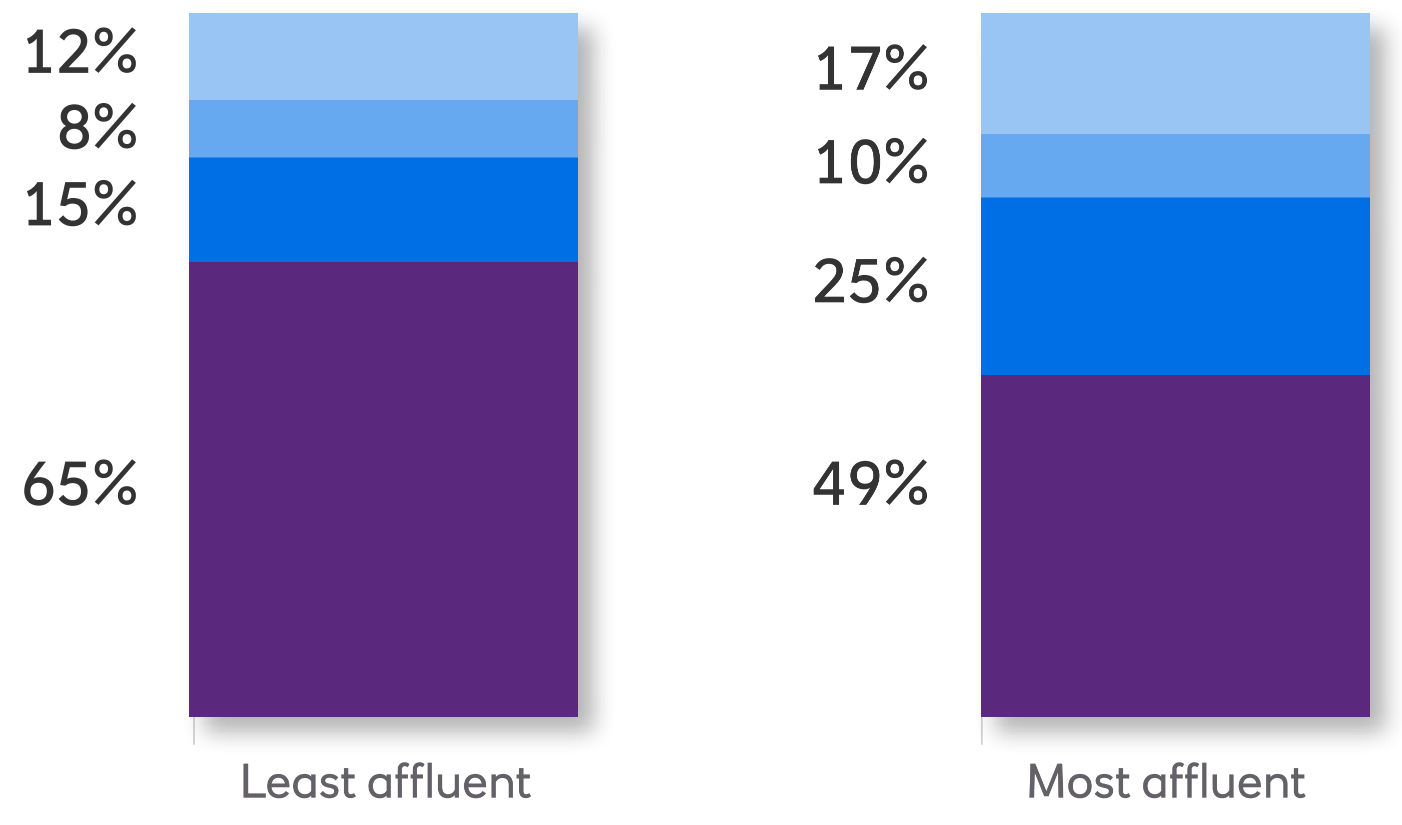
The least affluent families have already seen their levels of discretionary income hit the hardest as staple expenditure such as food, energy and transport experience significant levels of inflation. The Retail Economics Cost of Living Tracker shows the least affluent faced an average inflation rate of 11.9% in 2022, compared with 9.8% among the most affluent. This comes on the back of annual food prices accelerating (hitting new 45-year highs of 16.5% in November), and home energy costs (electricity and gas) almost doubling compared with the previous year.

"In 2022, the least affluent faced an inflation rate of 11.9% – the most affluent 9.8%."

Contents

Section two: the outlook for 2023.

(**13**) Least affluent households spend highest share of income on essentials driving inflation.



Sources: ONS, Retail Economics analysis 2023.

Strong earnings growth among the most affluent households meant that by late 2022, they were able to offset the impact of double-digit price rises across essential goods.

Earnings growth in private sector industries has significantly outpaced the public sector, with the most affluent typically working in industries such as professional services, which are more resilient to lockdowns and downturns.

As wage disputes intensify with little resolution heading into 2023 (eg rail, health, postal services), wage expectations among the least and middle affluent households are weaker than the most affluent.

Among those anticipating pay increases in 2023, our research shows that the least affluent expect a 3.9% annual increase, middle income a 4.2% rise and the most affluent a 4.4% increase. Stronger earnings expectations signal differing degrees of confidence among the most affluent households, which will likely result in a greater propensity to spend.

Higher levels of savings will also support more resilient spending for the most affluent. For comparison, a net balance of 23% for the least affluent have seen their savings decrease since the pandemic, while a net balance of 30% for the most affluent households have seen an increase. Middle-income households broadly experienced marginal change. This comes on the back of £260bn of additional savings accumulated during 2020/21 lockdowns, skewed towards affluent households (benefiting from increased ability to work from home and saving on leisure activities, commuting and cancelled holidays) – partially mitigating inflation impacts.

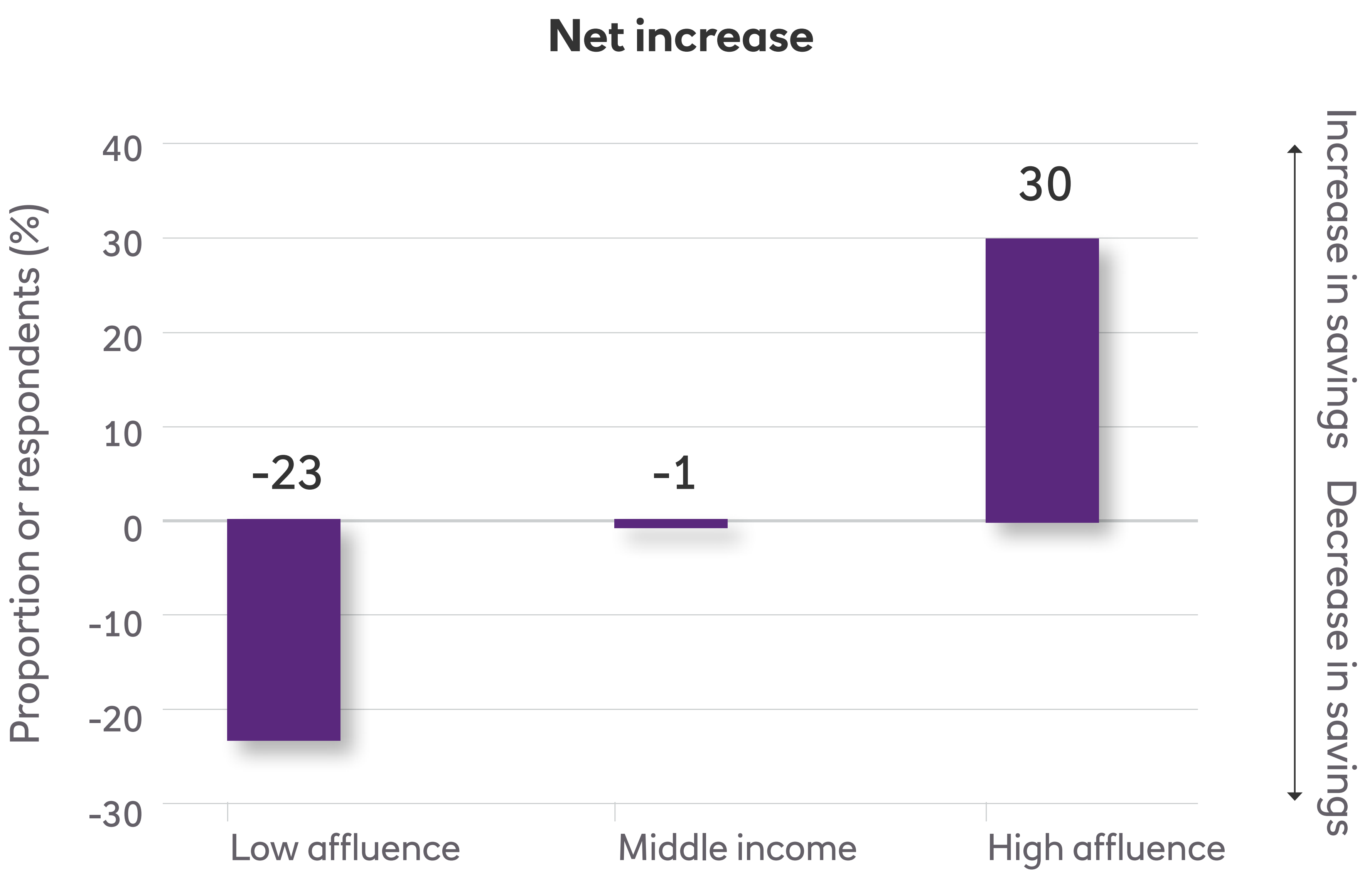
"Of those anticipating a pay rise in 2023, the least affluent expect a 3.9% increase, middle-income 4.2% and the most affluent, 4.4%."

Contents

Section two: the outlook for 2023.

(**14**) Most affluent have ramped up savings as least affluent dissave.

Q: *What's happened to overall level of savings since the pandemic?*



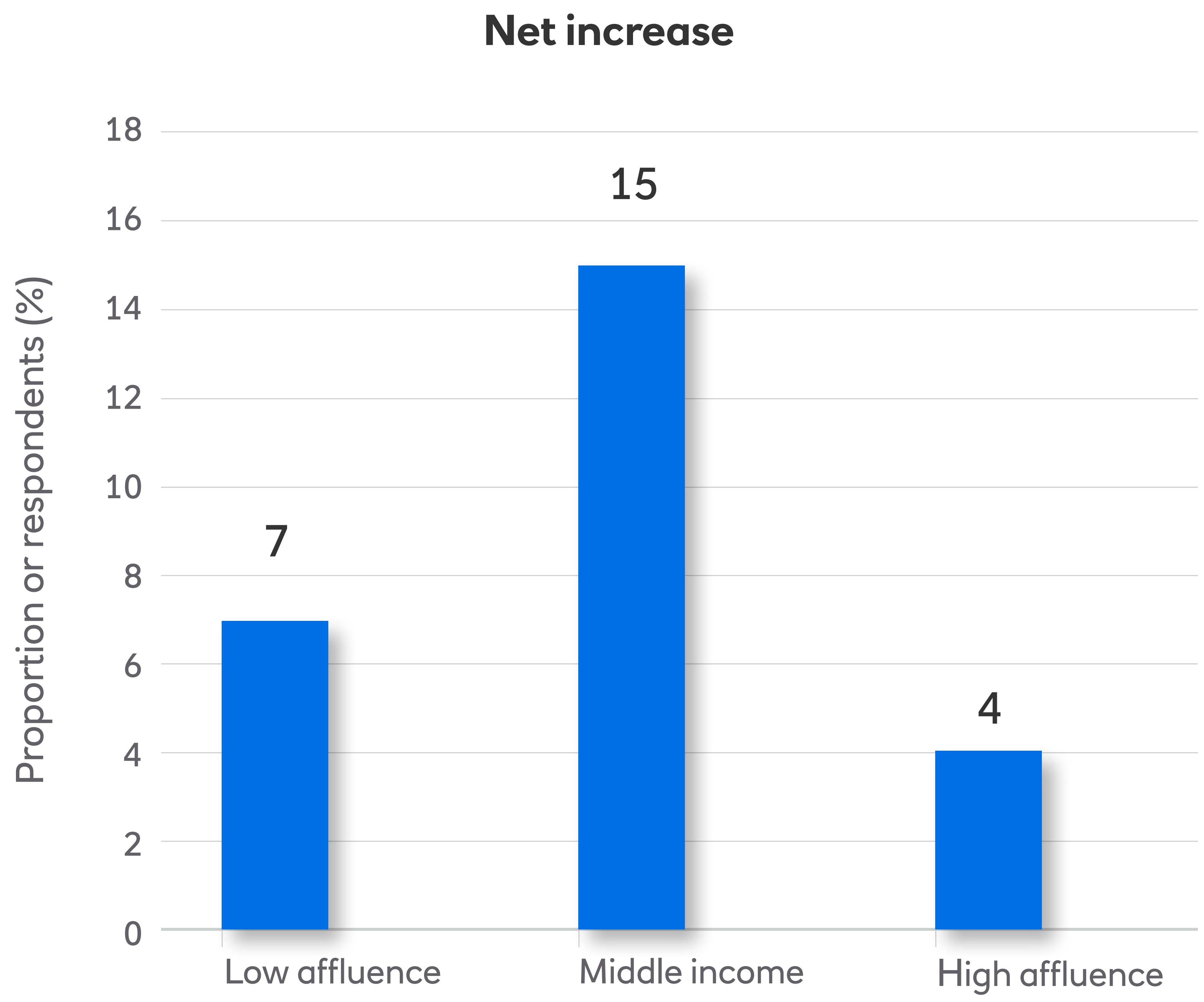
Source: Retail Economics 2023.

Nevertheless, over half of consumers feel like their finances will weaken over the next 12 months, partially a result of the ninth consecutive rise in interest rates by the Bank of England to 3.5% in December 2022, projected to rise to 5% by Q3 2023.

Unsurprisingly, hikes in interest rates have widened the scope of consumers impacted by the cost-of-living crisis. Indeed, our data shows that middle-income households are more likely to have taken on more debt since the pandemic as they leverage access to loans to maintain lifestyles.

(**15**) Low and middle-income households most likely to have increased debt since pandemic.

Q: *What has happened to overall level of savings since the pandemic?*



Source: Retail Economics 2023.

Contents

Section two: the outlook for 2023.

Crucially, a year of interest rate rises is concerning for those looking to remortgage over the next year and beyond, as a decade of ultra-low rates unwinds. A net balance of 44% of those with mortgages are worried about interest rate rises in 2023, compared with 26.1% of homeowners (without mortgages) who aren't worried.

Over two million households are set to remortgage in 2023. Some 80% of those remortgaging before the end of next year will have enjoyed rates of 2.5% or lower.

The average two and five-year fixed rate was around 6% at the end of 2022. Assuming an average balance of £150,000 on a 30-year mortgage term, mortgaging at a 6% rate, would see fixed-rate mortgage holders needing to renew this year, pay an extra £345 per month. This equates to £8.3bn in annual payments collectively from two million impacted households.

“44% with mortgages worry about rising interest rates.”

(**16**) Mortgage sensitivity: 6% rate mortgage holders would pay extra £8.3bn in payments per year on £150,000 balance.

Mortgage balance	**Mortgage repayments** at average 2% mortgage rate	Additional repayments				
		at 3%	at 4%	at 5%	at 6%	at 7%
£50,000	£185.00	£26.00	£54.00	£83.00	£115.00	£148.00
£100,000	£370.00	£52.00	£107.00	£167.00	£230.00	£295.00
£150,000	**£554.00**	**£78.00**	**£162.00**	**£251.00**	**£345.00**	**£444.00**
£200,000	£848.00	£100.00	£208.00	£321.00	£441.00	£566.00
£300,000	£1,109.00	£156.00	£323.00	£501.00	£690.00	£887.00
£400,000	£1,478.00	£208.00	£432.00	£669.00	£920.00	£1,183.00
£500,000	£1,848.00	£260.00	£539.00	£836.00	£1,150.00	£1,479.00
£1m	£3,696.00	£520.00	£1,078.00	£1,672.00	£2,300.00	£2,957.00

Term assumed: 30 years.
Source: Retail Economics 2023.

Contents

Section two: the outlook for 2023.

Renters are also feeling the pressure as landlords pass on higher housing costs. At the end of 2022, rental price growth was at its highest rate in six years at 4% (ONS).

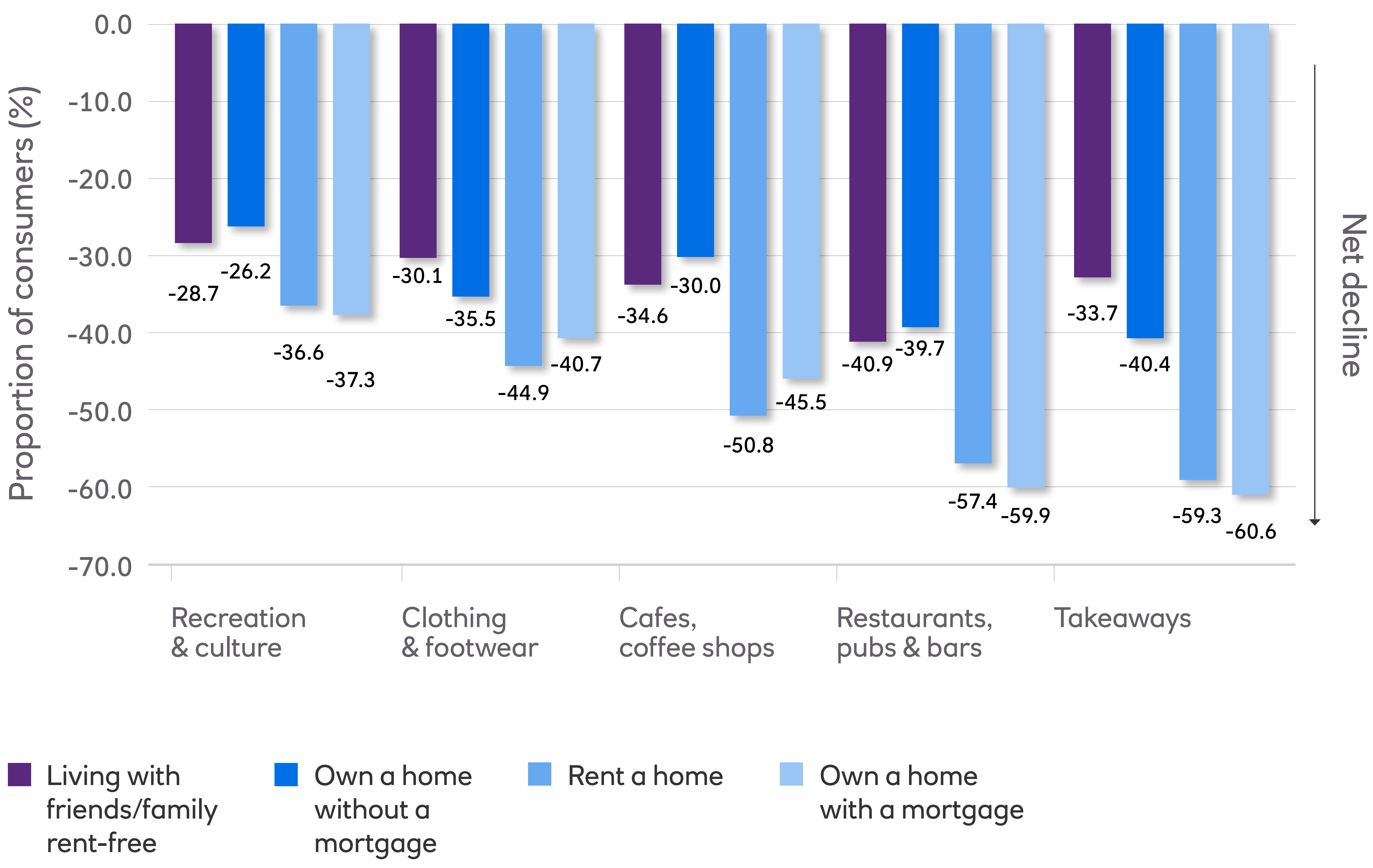
This is significant because renters spend a disproportionate amount of income on accommodation, meaning their discretionary spending power is at greater threat from rising rental values. On average, renters spent a total of £106.50 per week on rent (after accounting for housing benefit, rebates and other allowances) – equivalent to 24% of their median weekly expenditure (ONS). This compared with mortgage holders who spent an average of 16% of their median weekly expenditure on mortgage repayments.

Clearly, the hit to disposable income from increased housing costs will weaken spending intentions. While the top five categories most likely to be impacted in 2023 are consistent between households (figure 17), mortgagers and renters are significantly more likely to cut back compared with those free from mortgages and rent.

Within these categories, renters and mortgagers are likely to put downward pressure on spending across mid-market brands, as 58.3% of those with a mortgage are middle-to-high and high-affluence individuals, compared with 50.7% of renters who are low-to-middle and low-affluent consumers.

(17) Renters and mortgagers cutting back harder than others.

Q: *Likelihood to change in quantity bought over the next 12 months?*



Source: Retail Economics 2023.

Contents

Section two: the outlook for 2023.

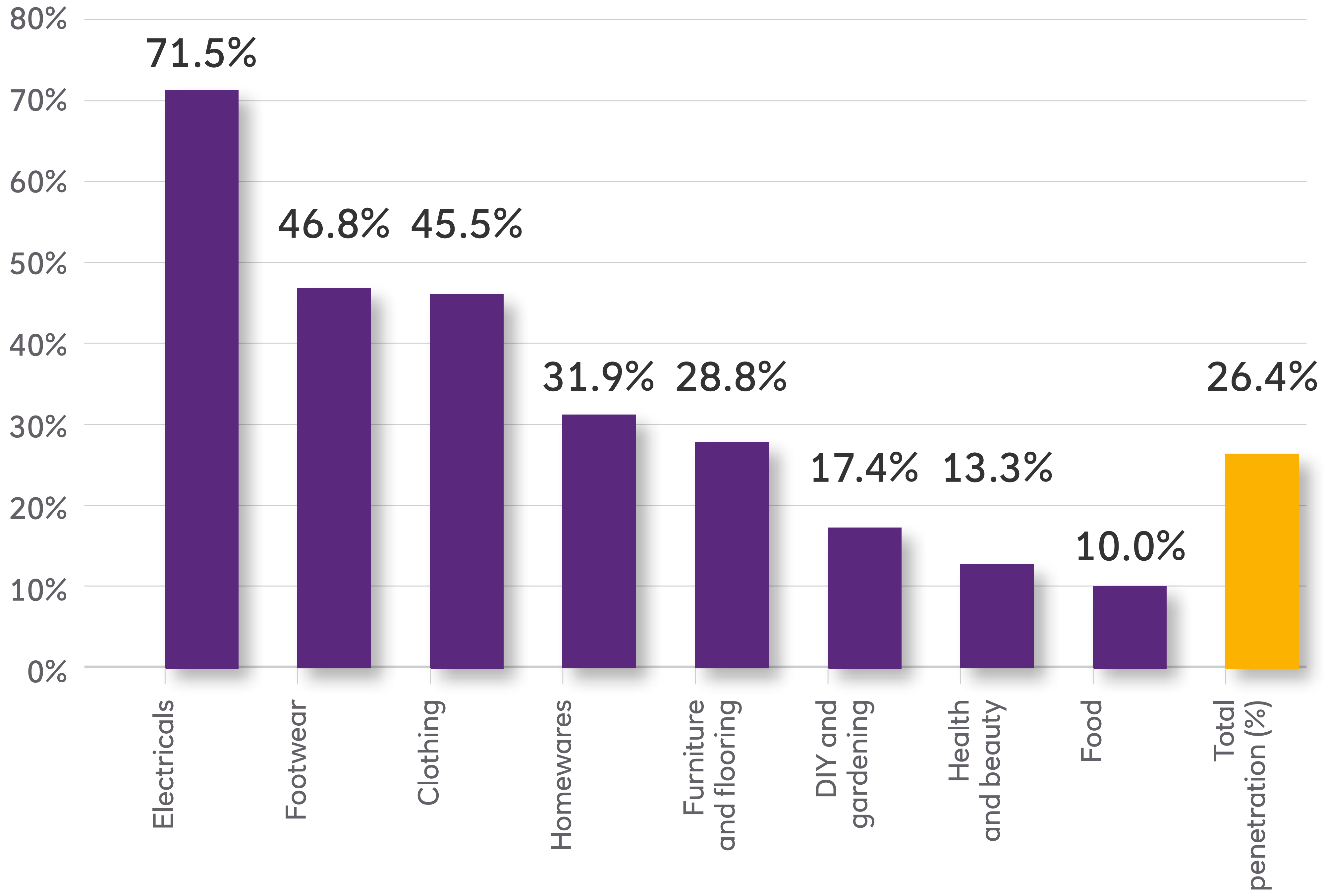
Trend three: stores adopting digital.
Summary | Consumers

- Digital adoption leading to shoppers wanting a connected customer journey.
- The pandemic brought a shift online, but e-commerce adoption varies by category.
- The cost of living crisis is seeing the role of stores change as the least affluent try to avoid online delivery/returns fees, which is driving intentions to shop in-store.
- Consumers demand digital integration in-store, including convenient payment options, extended product information and store collection.

The online retail ecosystem saw unprecedented levels of investment throughout the pandemic as retail brands upscaled, pivoted and developed their digital propositions. Many businesses accelerated their digital capabilities at a time when consumers increasingly bounced between physical and digital channels on their path to purchase.

Online sales accounted for just over a quarter of total retail sales heading into 2023, following a 37.8% peak during pandemic-induced store closures. The shift online continues to disrupt traditional store performances, leaving legacy retailers needing to consolidate and reinvent excess store space. However, the magnitude of shift varies across categories. Electricals and apparel, for example, experience higher online penetration than health, beauty and food, where physical touch and small basket purchases are critical.

(**18**) Online penetration rate forecast across 2023.



Source: Retail Economics 2023.

Contents

Section two: the outlook for 2023.

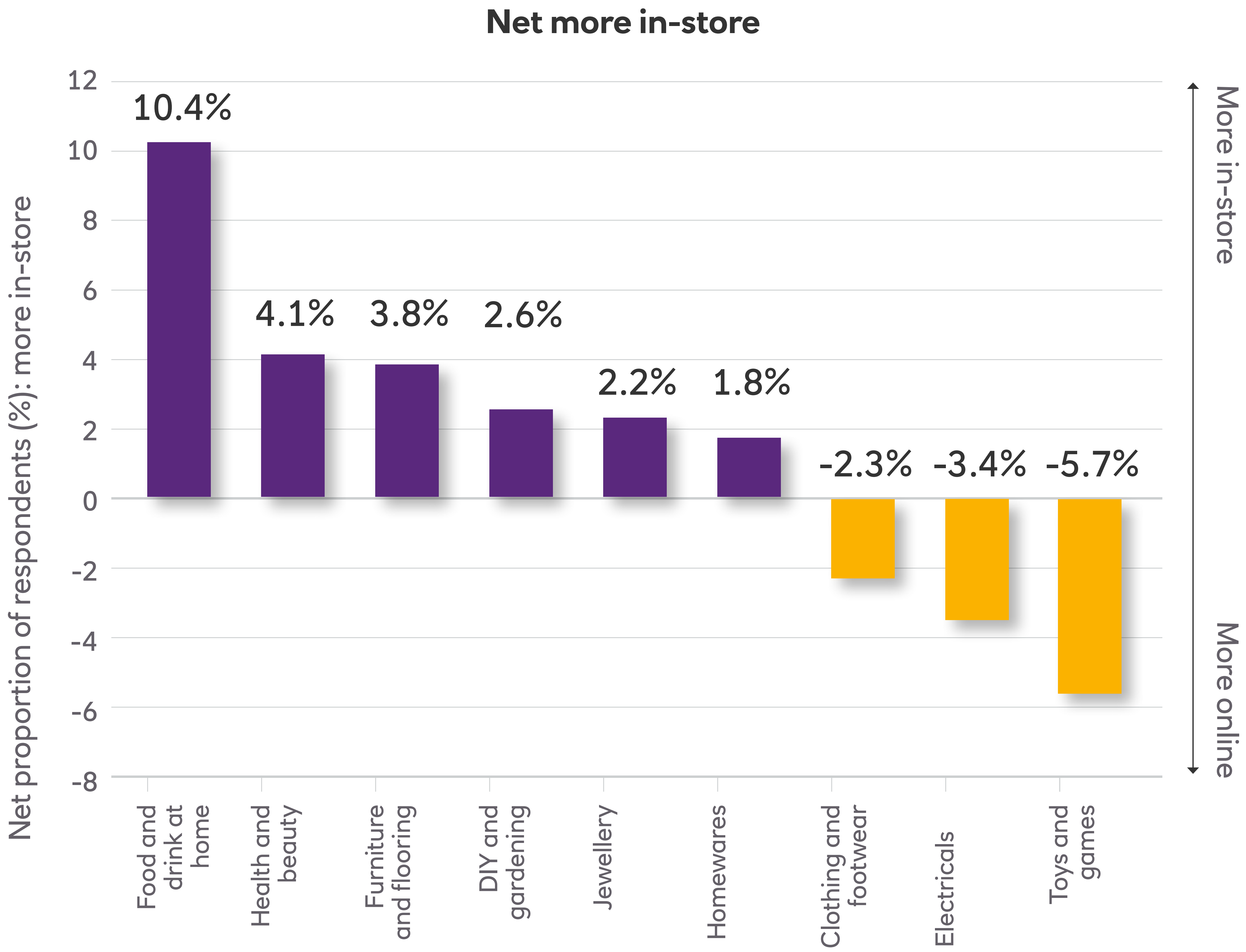
However, as pandemic impacts fade, the cost-of-living crisis has accelerated store retrenchment for many consumers as they seek the comfort of traditional shopping habits during distressed times. The squeeze on incomes has prompted consumers to reconsider the channels they engage with to seek out the best deals. In some parts of the sector, it has enticed consumers back into stores, a trend that is expected to continue in 2023 as pre-Covid online penetration rates continue to normalise.

Our research also shows affluence is a significant factor that will motivate consumers to migrate more spending online throughout 2023. It shows that the least affluent are five times more likely to spend a greater proportion of their expenditure in-store.

"The least affluent are five times more likely to spend more in-store."

(**19**) Intentions to shop more in-store.

Q: *Thinking about your shopping habits throughout 2023, do you think the proportion you will spend in-store or online will change in any of the following categories?*



Source: Retail Economics 2023.

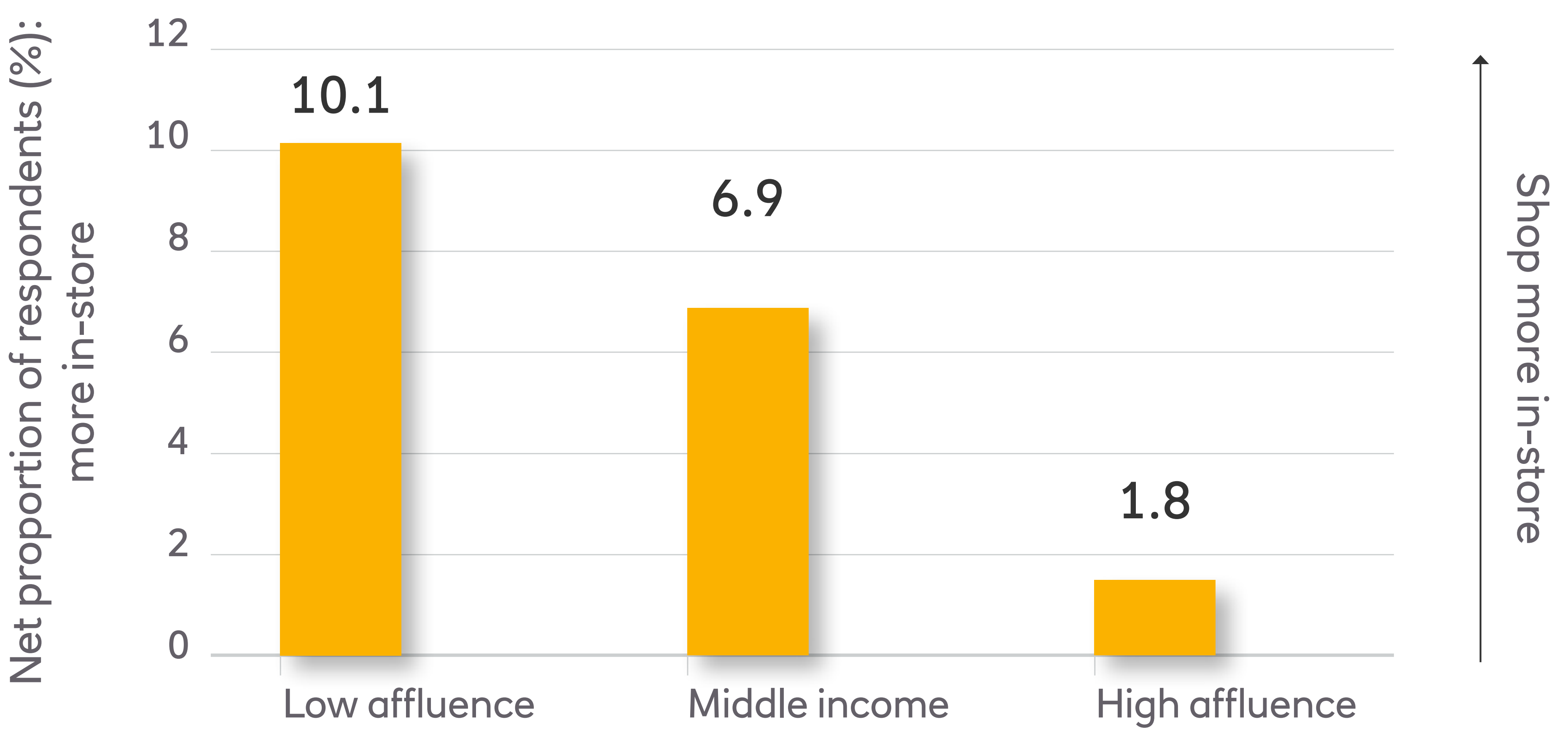
Contents

Section two: the outlook for 2023.

(**20**) Those under most financial pressure are looking to shop in-store.

Q: *Do you think the proportion you will spend in-store or online will change?*

Weighted average across retail categories



Source: Retail Economics 2023.

Interestingly, shoppers are reverting to physical store across categories that faced a drastic shift online during the pandemic – particularly food, which is likely to continue to put downward pressure on online players. But as discretionary budgets erode due to inflation, consumers are looking to spend more in-store over the next year to avoid online delivery and return fees, as well as minimum order spends. Our findings reveal various motivations influencing the balance between digital and physical touch points across the customer journey.

"With no budget for non-essentials, consumers need to exert willpower, avoiding tempting online offers."

Contents

Section two: the outlook for 2023.

(**21**) Shopper motivation.

Shopper motivation	Summary
Seek local markdowns	Local markdowns specific to stores mean shoppers can benefit from deals outside of seasonal or national promotions. These include clearance of perishable goods (eg Tesco's rebrand of its "reduced to clear" aisle to "reduced in price – just as nice").
Save on escalating delivery and returns fees	Retailers have recently passed on higher operating costs to consumers, including charging for delivery/returns across categories that previously offered free services (eg Boohoo and Zara introducing returns fees in 2022).
Disciplined spending	The erosion of budgets for non-essentials means consumers need to exert willpower over their spending. This may involve avoiding tempting online offers and digital payments – expect more physical transactions and thorough price comparisons.
Smaller basket sizes to spread costs	Consumers seeking lower-value transactions in order to manage cashflow, which can be lower than minimum spends or make delivery fees unjustifiable proportional to basket sizes – particularly for food.
More considered purchases: touch and feel to validate items	Higher-priced items or goods that are difficult to replicate online typically need consideration through touch and feel in-store, including home-related items and beauty.
Time-poor or distressed	Distress purchases or for immediate jobs (eg DIY), with speed and convenience of store transactions a priority. This extends to consumers looking to maximise job opportunities ahead of a potential recession being left time-poor.
Buy homogenised products at the best price	When shoppers are looking to purchase a specific product/brand (rather than buy from a specific retailer), online transparency provides easy access to homogenous products at the cheapest price, particularly across toys, electricals and branded apparel.

Source: Retail Economics.

Despite rebalancing towards in-store sales, digital touchpoints across the entire customer journey have become much more influential in recent years, accelerated by the pandemic.

Consumers expect a seamless transition between in-store and online. This has led to an integration of digital services and in-store technology to unify cross-channel experiences.

Our research shows that shoppers are keen to capitalise on the benefits of digital technologies in physical stores. This includes a quarter of consumers wanting more convenient payment options (eg to align with online payment options) and educating in-store (eg to save researching online at home). Furthermore, around one in six want store collection to save on delivery or returns fees. Interestingly, the top three in-store initiatives are consistent across retail categories, albeit the order differs marginally (see figure 22 on next page).

"A quarter of consumers want more convenient payment options in-store."

Contents

Section two: the outlook for 2023.

(**22**) In-store initiatives shoppers want to see.

Q: *What initiatives would you most like to see more of in stores over the next 12 months?*

Source: Retail Economics 2023.

Trend four: the future of work. Summary | Consumers

- Hybrid working taking hold post-pandemic, with changes to the labour market impacting footfall rates.
- Increased rebalance between in-store and online sales.
- Those expecting to work from home more over the next year are increasingly likely to visit local stores, while those anticipating attending workplaces more are driving city and shopping centre footfall.
- Hybrid workers are among the most affluent, and more likely to feel confident about personal finances in 2023. But they also face rising housing costs, leading to a greater propensity to trade down or delay spending compared with the average.

The pandemic disrupted the UK labour market, impacting typical spending habits. Around two-fifths (42.5%) of workers now adopt hybrid working patterns. A redistribution of spending has occurred across physical channels with the average number of office days falling to 1.4 days per week, compared with 3.8 days pre-pandemic (Advanced Workplace Associate). Increased home working has encouraged consumers to spend more locally, while increasing successful home deliveries has bolstered the online channel. Consequently, this shift has negatively impacted city-centre shopping, given that hybrid working primarily affects higher-paid professionals more likely to work in these locations.

Contents

Section two: the outlook for 2023.

However, for many companies hybrid working remains unsettled, with many workers volunteering for more office days and company policies encouraging workers back to offices. As the work environment remains in a state of flux, so too is the distribution of spending for this important cohort of consumers.

This more affluent consumer segment also displays complex customer journeys that rely on digital touchpoints throughout. The pandemic not only shifted a greater proportion of sales online, but it elevated the importance and reliance on digital technology across pre and post-purchase stages such as awareness, research, fulfilment, service, returns and social commerce.

Our research shows that while consumers intend to interact more in physical locations over the coming months, this interaction needs to be contextualised with a greater reliance on digital touchpoints (eg retailer apps for stock checking, store location finding, in-store product navigation and click and collect). In-store smartphone purchasing (and organising home delivery) is also commonplace.

The evolution of hybrid working will play a vital role in the distribution of channel spending and will make deciphering footfall, and the value and purpose of stores, ever more complicated.

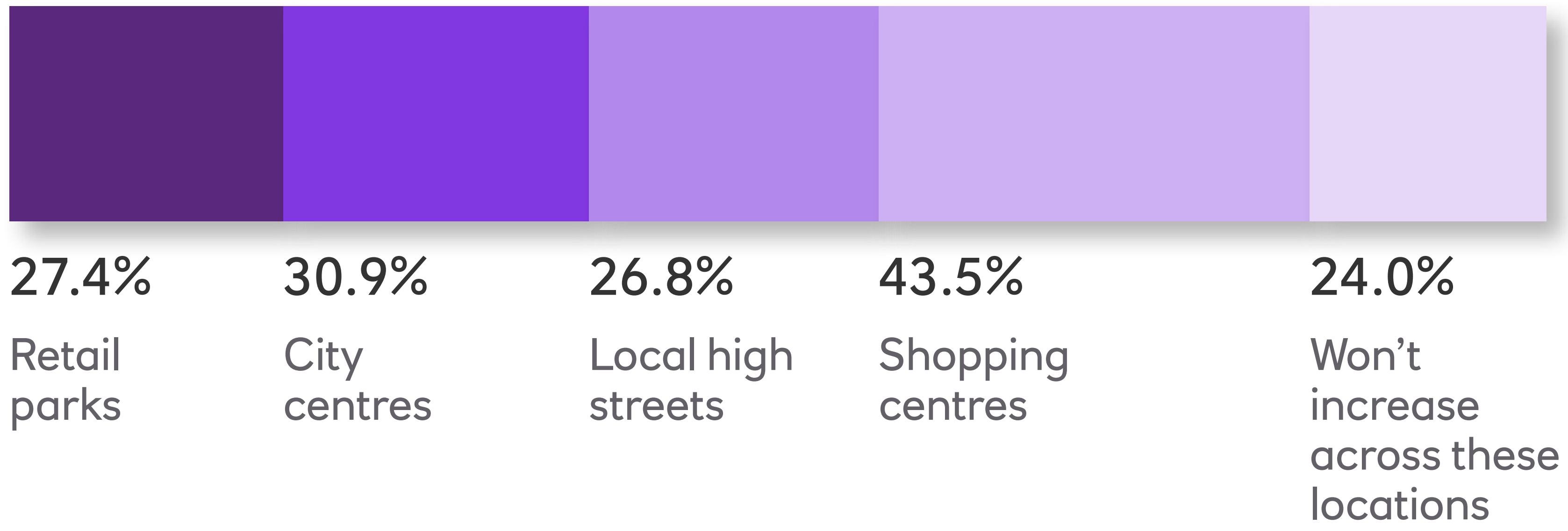
Consumers working in their normal workplaces more are most likely to be driving in-store visits, particularly to shopping centres and city-centre locations where they operate from.

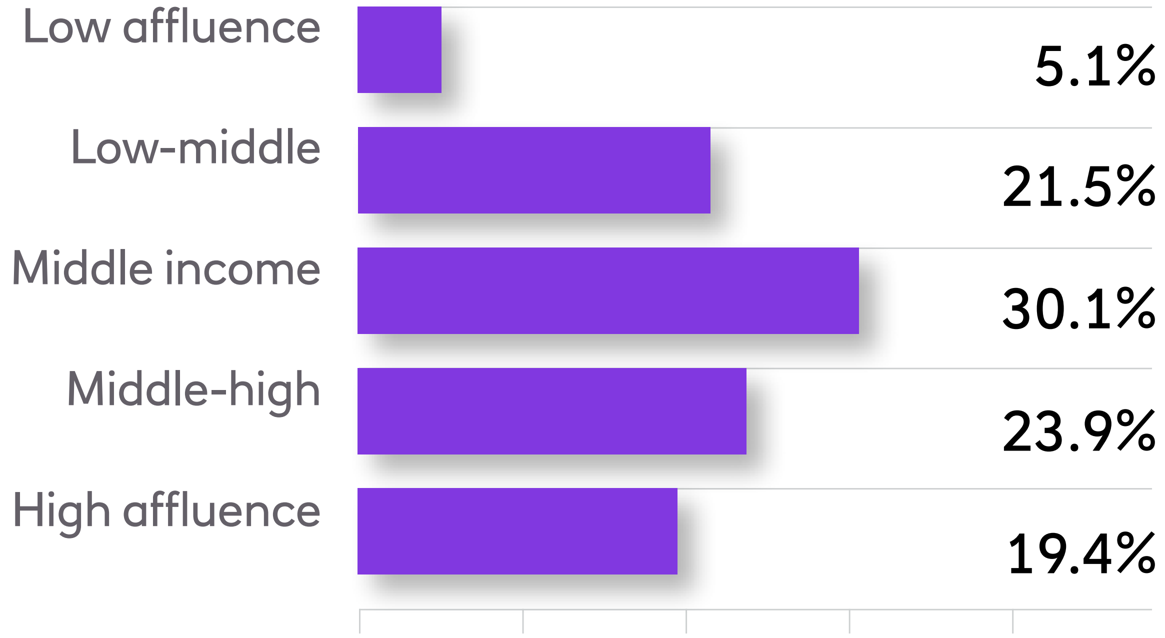
This is followed by those who are set to work from home *more*, who are most likely to drive greater levels of footfall to local high streets compared with other workers – consistent with pandemic trends of shopping locally as consumers spent more time in their immediate vicinity. Those facing no changes to their work environment are the least likely to change their store visits in 2023.

Contents

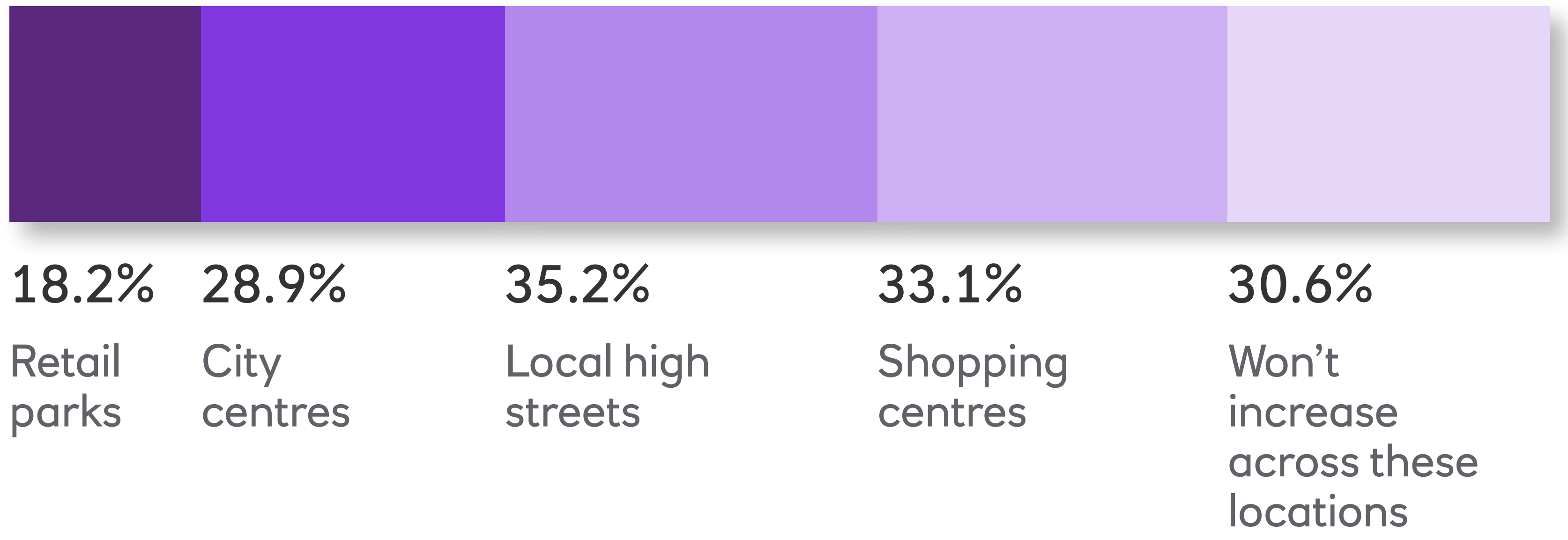
Section two: the outlook for 2023.

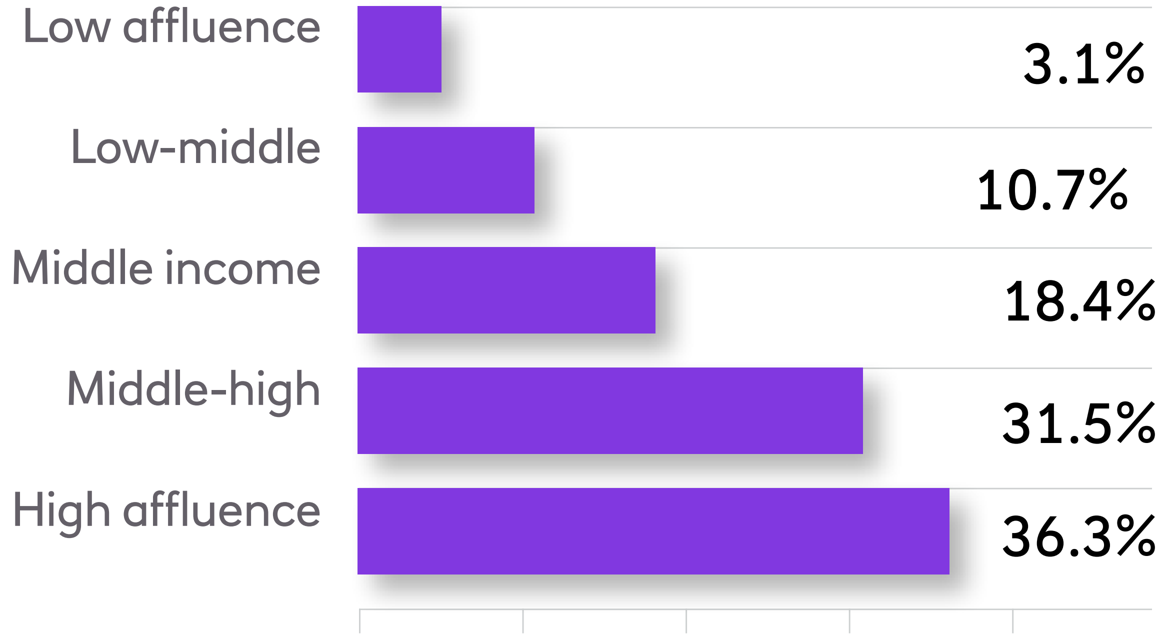
Work from workplace more



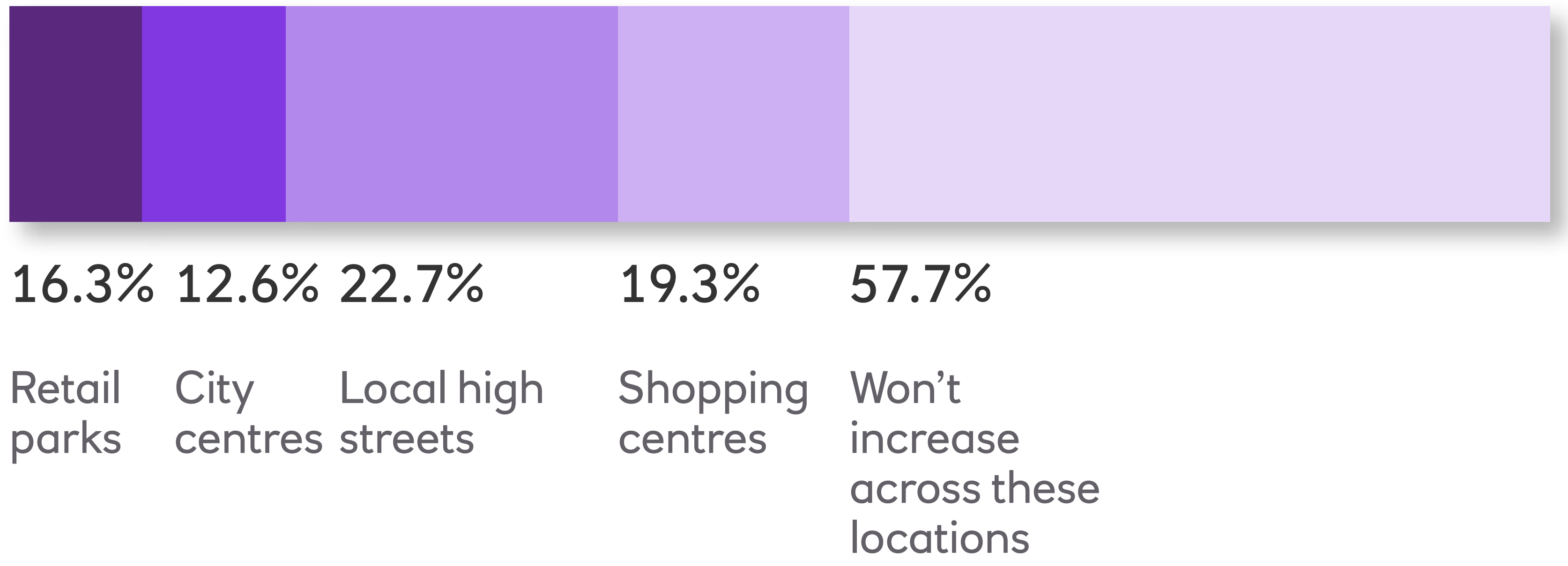


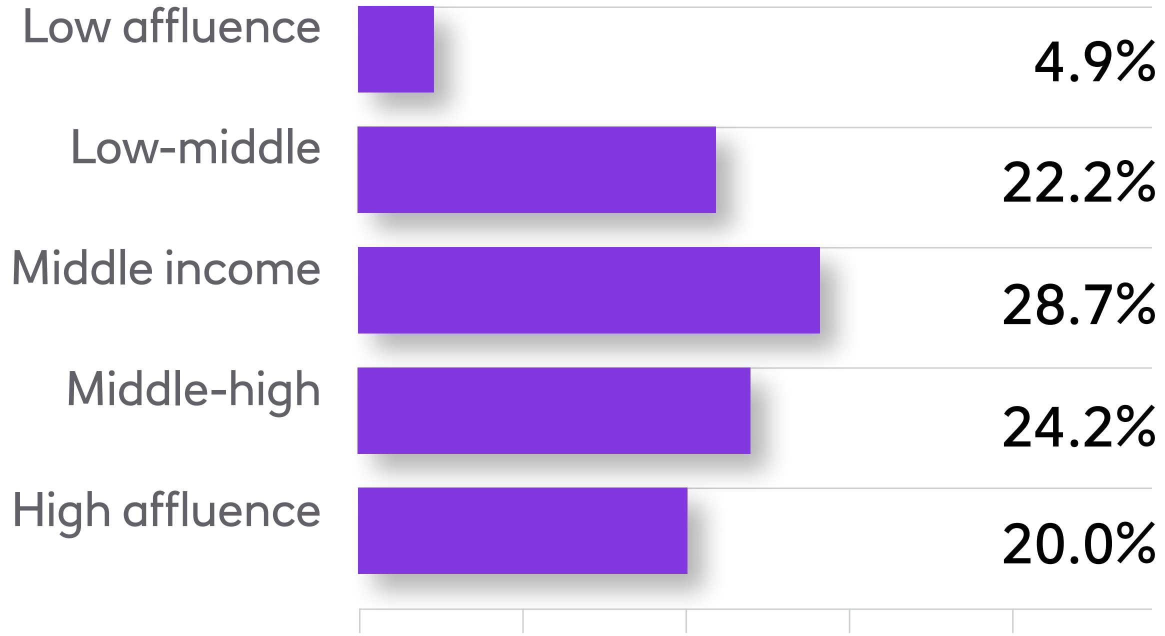
Work from home more





No change





Source: Retail Economics 2023.

(23) Return to place of work driving footfall in 2023.

Q: *In 2023, do you think you will visit any of these locations more frequently?*

How to read this chart: The rows in the table split responses across three consumer cohorts: those expecting to work from their workplace more in 2023; those expecting to work from home more, and those who don't expect changes in their working environment.

Charts in the left column plot the proportion of consumers who expect to visit retail and hospitality locations more frequently. Charts in the right column break out the distribution of affluence for each of the three cohorts.

Note – options are multiple choice and don't sum to 100.

Contents

Section two: the outlook for 2023.

As previously mentioned, those likely to work from home more are also more likely to be higher earners. A net balance of 8.1% of the most affluent consumers are set to work from home more in 2023, compared with a balance of 10.5% among the least affluent, set to work from home less.

Higher earners also feel more confident about their personal finances in 2023. Those expecting to work from home more are almost three times more likely to expect their finances to strengthen over the next year. Among them, 30.2% expect their finances to strengthen, compared with just 13.2% among the average.

But work-from-home consumers are still adjusting their spending against the harsh economic backdrop. Around three fifths (60.1%) of those set to work from home more are worried about housing costs, compared with an average of 40.4% among the general population (as 41.6% of hybrid workers have mortgaged homes, compared with 29.6% that either always work from home or in workplaces).

This means that while those expecting to work from home more are less likely to stop spending across categories such as electricals, takeaways and homewares compared with the average, they're more likely to trade down or delay spending across retail and hospitality categories.

"Work-from-home consumers are three times more likely to expect stronger finances in 2023, but 60.1% of them worry about housing costs."

Trend five: considered and sustainable shopping. Summary | Consumers

- Younger consumers are driving demand for sustainability and most are willing to pay for it.
- More than eight in 10 of the youngest consumers would shop more with firms that have strong sustainable values.
- Pressure to adapt in the short term varies by category. Consumers are most likely to seek sustainability across apparel, food and beauty.
- Around two in five believe retailers have the greatest impact to drive change towards sustainable practices within the industry.

A more sustainability-conscious consumer is emerging. Their behaviour is being influenced by extreme weather events, the UK's 2050 net-zero commitment and growing awareness of environmental impacts of over-consumption.

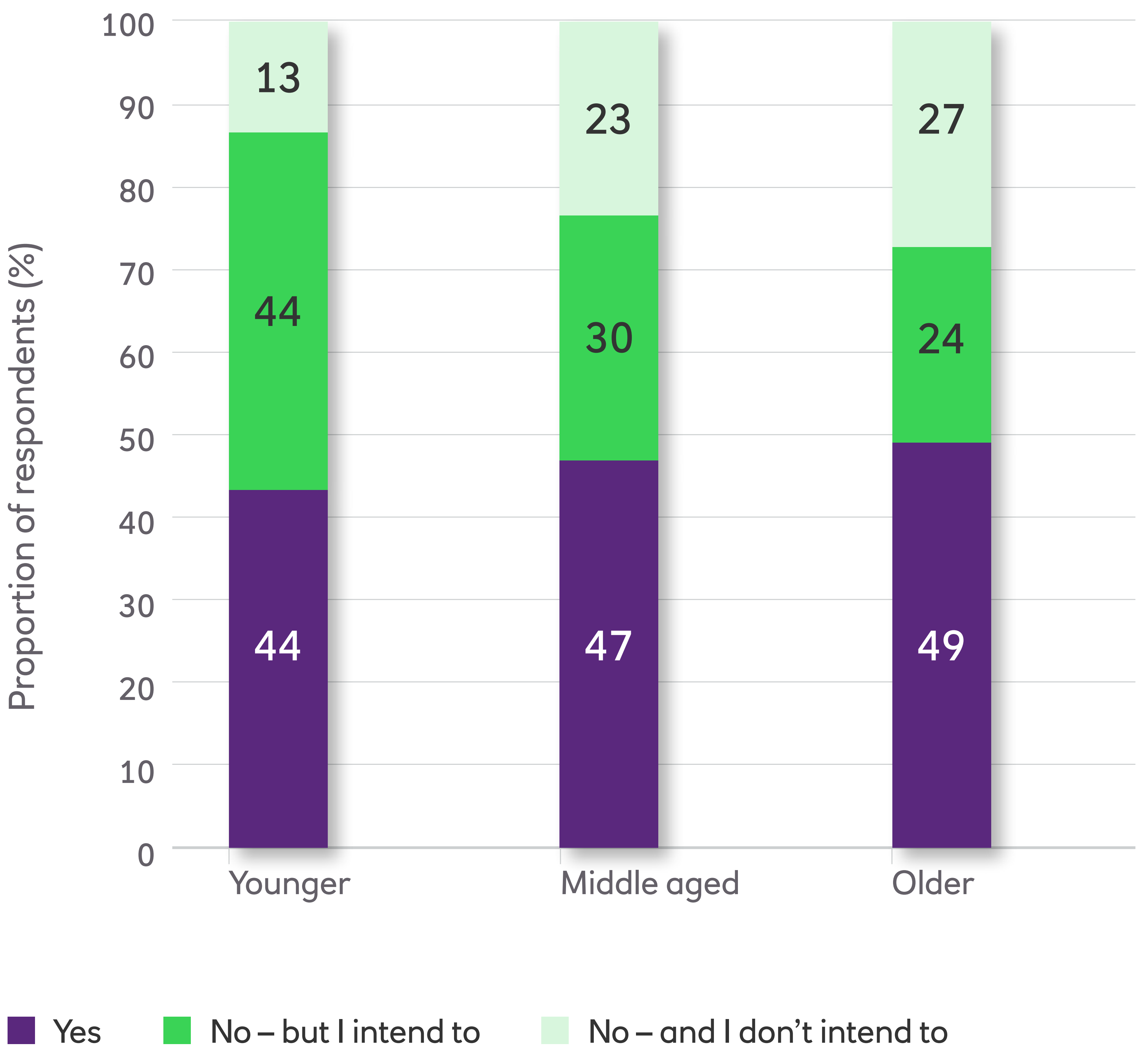
However, attitudes towards sustainability and willingness to pay for more sustainable consumption vary significantly by age. Younger shoppers (who are becoming more economically significant) have the greatest intentions to shop more sustainably, although their actions don't always follow accordingly. While younger shoppers are the least likely to have made any changes in reducing their environmental impact, 44% intend to do so in the future – almost twice that of the oldest consumers. This may reflect the price differential for some sustainably sourced products.

Contents

Section two: the outlook for 2023.

(24) Younger consumers almost twice as likely to want to reduce environmental impact compared with older consumers.

Q: *Are you making any changes to reduce the environmental impact of your consumption?*



Source: Retail Economics 2023.

A high 84% of the youngest consumers would shop more with retailers and hospitality businesses demonstrating strong sustainable values. They're also willing to pay more, which provides a key opportunity for firms to create a point of differentiation by investing in sustainable practices. Younger shoppers are three times more likely to pay more for products from businesses with strong ethical and environmental values, compared with older consumers.

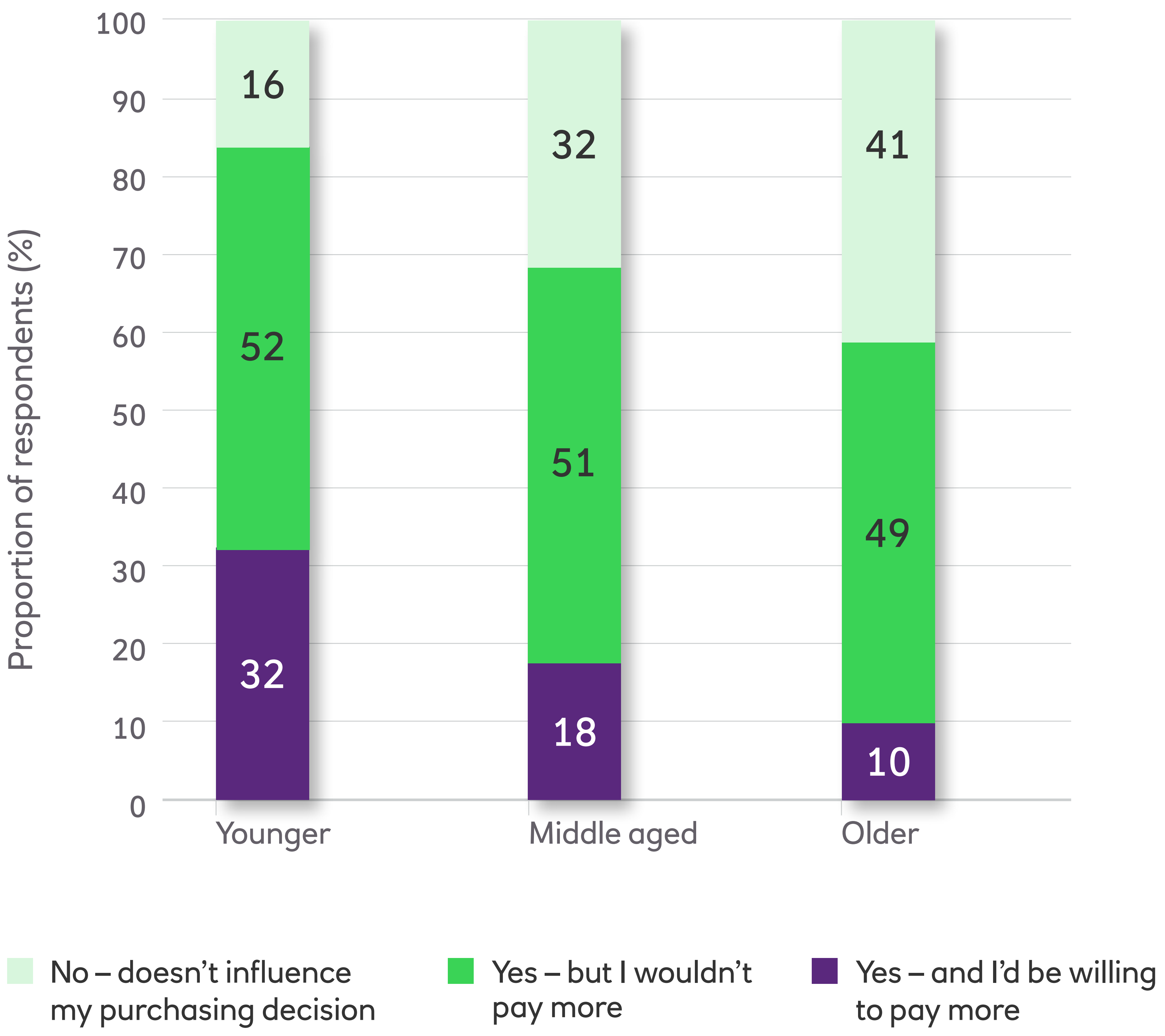
"84% of the youngest consumers would shop more with retailers and hospitality firms with strong sustainable values."

Contents

Section two: the outlook for 2023.

(25) Younger consumers three times as likely to pay more for environmental values than older consumers.

Q: *Would you be more likely to shop more with retailers and hospitality businesses that have strong ethical and environmental values?*



Source: Retail Economics 2023.

The pressure to deliver on sustainable practices is being felt unevenly across categories. Two-fifths of consumers seek sustainable products within clothing, footwear and food and drink at home, followed by health and beauty (27.4%) – significantly ahead of other categories.

Apparel and beauty are particularly susceptible to scrutiny around ethical standards, while food has relatively transparent sourcing practices, which drives greater awareness and sensitivity compared with categories such as furniture and flooring with longer product life cycles.

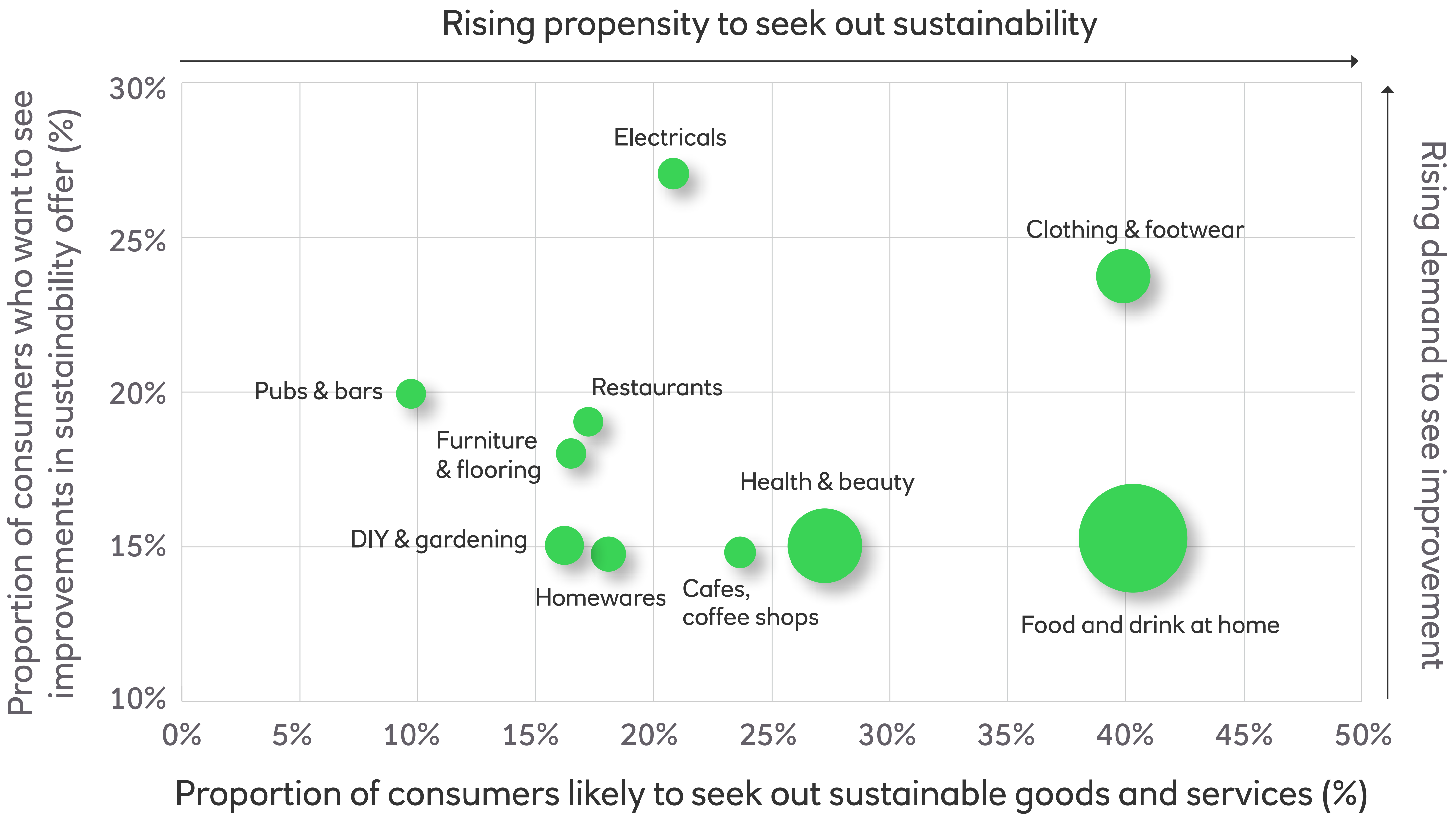
Essential categories like food and grocery, clothing and footwear, and health and beauty face increased likelihood of consumers wanting to cut back with cheaper alternatives. For retailers looking to pass on sustainability costs to shoppers, targeting younger and more affluent consumers with a greater willingness to pay could be a consideration. Categories where consumers want to see improvement in sustainability are often those popular with younger consumers, such as electricals, apparel, pubs, bars and restaurants.

"Two fifths of consumers seek sustainable clothing, footwear and food and drink at home."

Contents

Section two: the outlook for 2023.

(26) A high two-fifths of consumers seek out sustainable products in apparel and food.



Source: Retail Economics 2023.

How to read this chart: The bubbles reflect different categories, with the size of bubble indicating the proportion of consumers looking to buy cheaper alternatives in that category (larger = more likely to trade down). The X-axis plots the categories consumers seek out sustainable goods/services in the most. The Y-axis plots the categories where consumers most want to see improvements in the sustainability offer going forward.

There's mounting pressure for consumer-facing industries to make credible changes. Around two in five consumers (38.1%) believe retailers have the greatest influence in realising sustainable practices – up significantly from 22% in 2021. This is ahead of the UK Government (36.1% in 2022 v 39.2% in 2021) and even shoppers themselves (25.6% in 2022 v 38.8% in 2021).

Younger shoppers are also more demanding of government compared with other age groups. More than two-fifths (43.1%) of Gen Z believe government has the greatest impact in reducing emissions from retail consumption, while Gen X and Baby Boomers are more demanding of retailers.

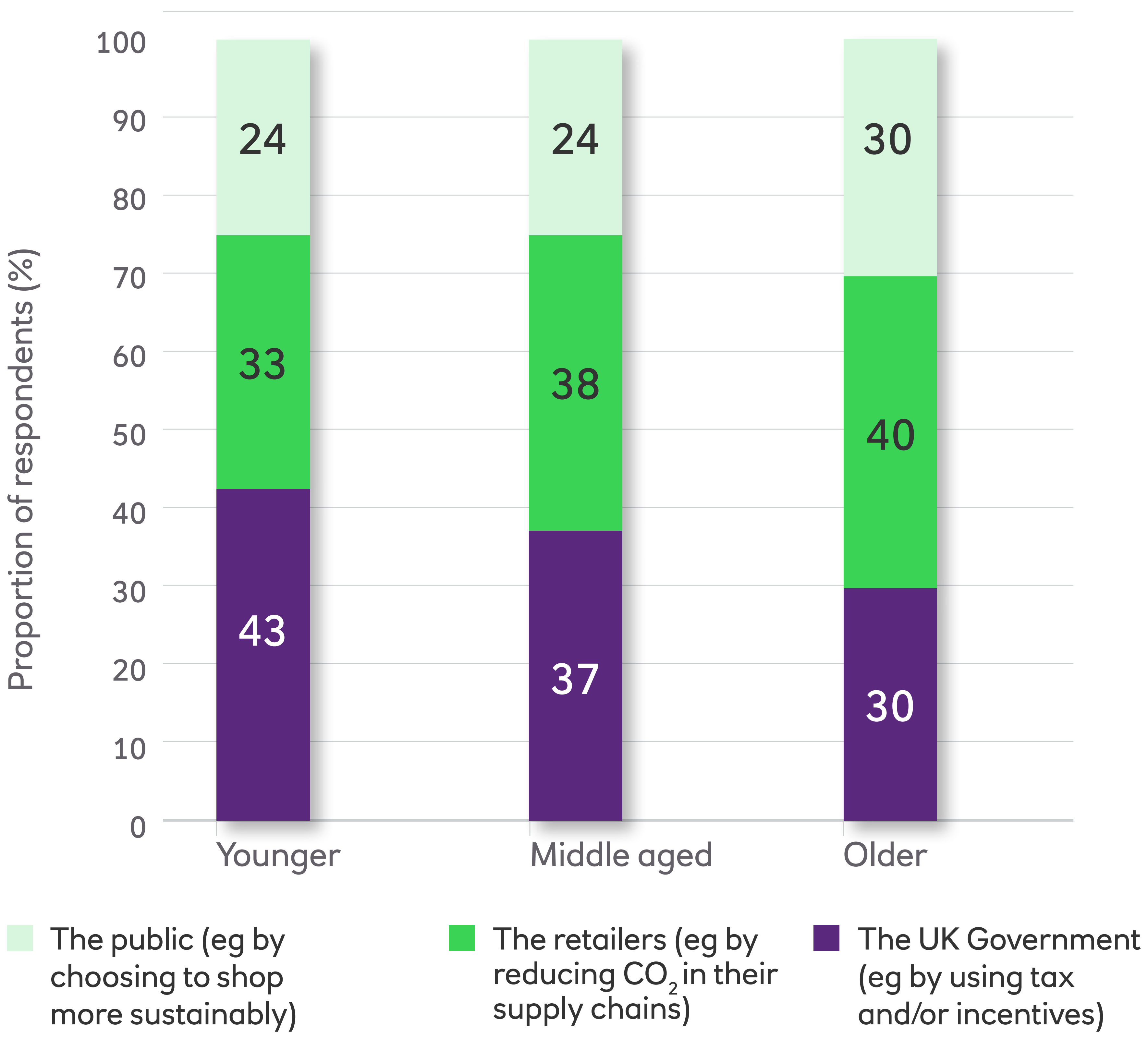
"38.1% believe retailers hold the greatest influence in realising sustainable practices."

Contents

Section two: the outlook for 2023.

(**27**) Two in five consumers believe businesses are responsible for driving sustainable practices.

Q: *Which of the following groups do you think can have the greatest impact on reducing carbon emissions from the consumption of retail products?*

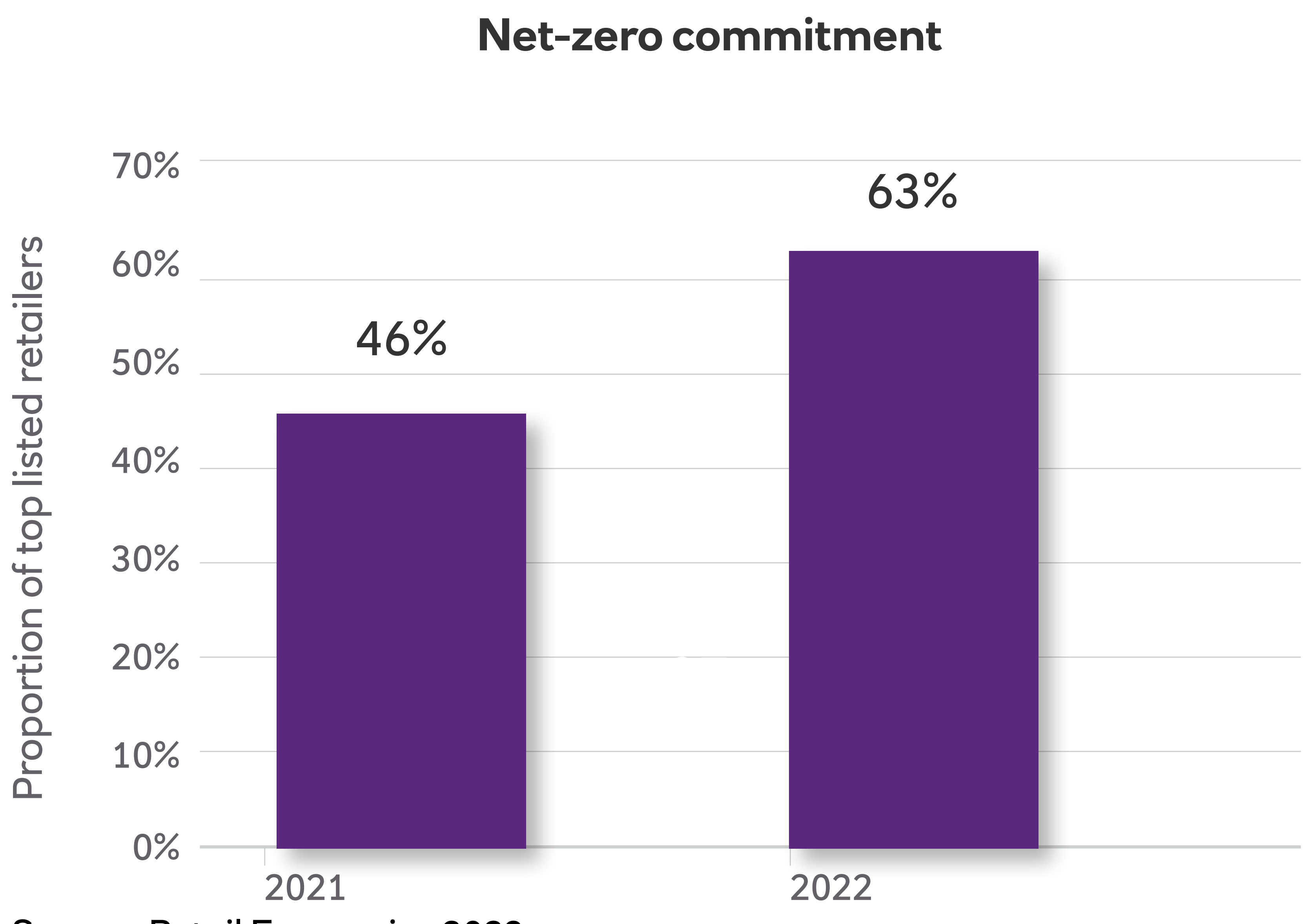


Source: Retail Economics 2023.

In reality, a coordinated approach must be adopted. This means implementing government policy, but consumer-facing industries clearly have a critical role to play. The UK Government's 2050 net-zero target provides a goal for businesses to work towards, but the level of commitment to net zero varies by sector and size of business.

Carbon commitments are increasing across the retail landscape. Our research shows that from a sample of the largest 52 listed UK retailers, nearly two-thirds have now committed to net-zero carbon emissions, up from less than half in 2021. From those with firm commitments, the average number of years to net- zero emissions is about 20 years away.

(**28**) Nearly two in three listed retailers now committed to net zero.



Source: Retail Economics 2023.

Contents

Strategies to survive and thrive in 2023

Top five priorities identified.

Section three: Strategies to survive and thrive in 2023.

For many, 2023 will be turbulent as recessionary events unfold. As such, successful businesses will need to act swiftly to improve ways of safeguarding operations and to leverage opportunities from the continued disruption.

Despite the absence of a blueprint for success, our research identifies five strategic priorities for businesses to focus on to better navigate oncoming headwinds.

1. Building business resilience.

Strategies for building resilience will vary widely depending on business models, but success will often rest on three factors: cashflow, liquidity and profitability. However, against a backdrop of rising costs and faltering demand, consumer-facing businesses will be tasked with making difficult trade-offs as cost-cutting measures are pitted against investment, marketing and growth opportunities.

In many cases, profitability will be the key priority, whereas for others boasting strong balance sheets, today's profitability can be sacrificed for tomorrow's growth in market share. In either case, retail and hospitality players will need to be proactive. They must take considered steps to offset the negative impacts of rising prices and weaker demand on achieving future goals.

Cost cutting and margin protection
A forensic examination of cost structures should be conducted to eradicate unnecessary expenses to help boost operational efficiencies, conserve cash reserves and improve productivity. Businesses may also consider divesting underperforming assets to improve cashflow and reduce leverage, especially as debt servicing costs rise amid higher interest rates.

Previous economic downturns show that outperforming businesses have been able to accumulate financial reserves heading into a downturn. This allows firms to remain price competitive and consider alternative range assortments to weather the storm more effectively.

Differentiating the customer experience
While cutting costs will be a priority, it shouldn't come at the expense of the customer experience. The cost-of-living crisis has caused a significant shock to consumer behaviour and, as shoppers reassess their needs and wants, businesses will have an opportunity to attract new customers, secure loyalty and even experiment appropriately using data driven approaches.

Leveraging data for intelligent customer segmentation will enable more targeted, relevant and personalised marketing that embodies empathetic communication. Amid a cost-of-living crisis, this will be critical to enhance the customer experience, which will build customer loyalty while protecting margins.

"The cost-of-living crisis is an opportunity to attract new customers, secure loyalty and even experiment."

Contents

Section three: Strategies to survive and thrive in 2023.

Supply chain efficiencies

The pandemic clearly highlighted the fragility of supply chains. Consumer-facing businesses will continue to diversify supply chains, digitalise their operations and collaborate with third-party logistics providers (or supply-chain-as-a-service providers) to build in greater flexibility and efficiency.

For apparel players in particular, this could imply partnering with a marketplace to scale operations and reach new customers via a third-party logistics (3PL) arrangement (eg Next's Total Platform) to leverage the existing infrastructure in place. Within hospitality, partnering with delivery platforms such as Uber Eats, Just Eat or Deliveroo could make commercial sense in some instances.

Meanwhile, the devaluation of the pound has also encouraged retail brands to seek alternative supplying countries in an attempt to mitigate rising input costs. The shift in supplier relationships will underline the importance of negotiating power between parties, with scale playing a critical role in securing lower costs and continuity of supply.

Ongoing pressure to reduce carbon emissions will encourage some to consider near-shoring, reshoring or onshoring where the economics allow. Supply chain security and digitalisation will be at the heart of increasing efficiencies and building resilience.

2. Implement intelligent pricing architecture.

Lower price entry points and assortment

While lower prices certainly influence decision-making, introducing low-priced entry points can attract budget-conscious shoppers without alienating core customers or diluting brand values. Lower entry price points can also help drive footfall into stores, which can lead to increased sales of higher-priced items.

Leveraging big data can significantly improve product assortment strategies that offer attractive price points, including lower-cost items and higher-margin options, while eliminating duplication and reducing the number of products. Some retailers may need to streamline their product selection while focusing on items aligned with their core brand values.

Intelligent pricing and promotion strategies can also help retailers protect margins alongside building more meaningful, long-term relationships with customers.

"Lower entry price points help drive footfall, leading to increased sales of higher-priced items."

Contents

Section three: Strategies to survive and thrive in 2023.

Dynamic pricing

Leveraging data science and analytics capabilities can identify where consumers are most price sensitive and which categories will have the least impact on profitability from price rises.

In some parts of the market, retail and hospitality providers can tailor pricing by customer, platform, channel and product segment, factoring for both margin performance and willingness to pay.

Retailers can also consider implementing personalised promotions and loyalty programmes, particularly for inflation-sensitive goods. This approach can foster customer loyalty and alleviate margin pressure by reducing the need for widespread promotions.

By utilising AI-powered pricing solutions, retailers can stay up to date on competitor prices, allowing them to remain competitive and protect margins.

3. Diversify, partner and acquire.

Increasing the addressable market

International expansion could emerge as a valuable strategy in 2023 as consumer-facing brands look outside of the UK to more buoyant growth markets. Given the uneven impact of inflationary pressures, exploring new territories can be an effective strategy to reduce exposure to territories with weaker or more volatile growth profiles.

Contents

Section three: Strategies to survive and thrive in 2023.

Win-win partnerships

Retailers are facing mounting pressure to excel in areas such as sourcing, merchandising and digital marketing. However, investing heavily in all these areas could further erode margins and damage profitability.

To reconcile this, brands should focus on their competitive advantages and points of differentiation, while also forming strategic partnerships to secure value in weaker operational areas.

Partnerships with tech companies, logistics providers, landlords, local authorities or other retailers/hospitality operators can help mitigate risks associated with innovation and enable businesses to reach new customers and achieve scale faster with cost-effectiveness.

For restaurant and hospitality businesses, this includes leveraging digital platforms such as Just Eat, Uber Eats and Deliveroo to offer rapid takeaway services that reach out to new cohorts, albeit at the cost of margins.

Retailers must also ensure that partnerships align with their brand values and support the customer experiences they wish to create.

Retail media

The next 12 months will see an acceleration in retailers leveraging the power of their own online platforms to monetise the exposure this provides to brands. Customer data will be used to optimise ads served to customers with more precision during their shopper sessions, with retail media commanding a higher proportion of digital marketing budgets from brands.

Acquisition opportunities

The current economic climate presents opportunities for companies to both enhance their capabilities and expand market share via strategic acquisitions. For organisations with robust balance sheets, turbulent market conditions frequently offer chances to acquire struggling companies.

Strategic acquisitions can provide valuable or specialised knowledge, enabling the acquiring party to increase capacity and capability in developing their offerings to in-store and online customers (eg Next and Frasers Group in the UK acquiring distressed retailers to diversify their portfolio of brands).

The combination of challenges suggests that consolidation in the pure online space and mid-market for both retail and hospitality are likely to be key themes throughout 2023.

4. Use environmental, social and governance (ESG) to your advantage.

Investing in sustainability across the value chain

As more businesses make carbon commitments, demonstrating ESG compliance is rapidly becoming a minimum expectation for many consumers and investors. Those unable to demonstrate adherence increasingly run the risk of reputational damage.

"Acquisitions can provide specialised knowledge – increasing capacity and capability, in-store and online."

Contents

Section three: Strategies to survive and thrive in 2023.

For many consumers, ESG is much more than carbon-neutrality. Truly ethical practices account for labour rights and community impact, as well as the environmental cost of sourcing and transportation. This will often require cradle to grave assessments, with integrated procedures for ongoing audits to ensure standards are maintained throughout the value chain.

Alongside greater visibility, substantial investment in new technology and processes will be essential to achieve the UK Government's net-zero ambitions, including investment in low-carbon technology such as renewable power across commercial buildings, battery energy storage in commercial property, electrification for short-haul transport and carbon capture and storage technologies where emissions are non-abatable.

To achieve net zero across operations, retailers and hospitality businesses will have to collaborate with suppliers and partners to ensure sustainability across the entire supply chain.

Circular economy

Awareness continues to grow around the impact of over-consumption. There's increasing normalisation and acceptance of resale markets, repair and recycling, and closed loop production where businesses repeatedly reuse the same materials to create new products.

For cash-strapped consumers looking to behave more sustainably, the rise of the circular economy offers an abundance of win-win opportunities. These include reselling used items, recycling, upcycling, offering rewards, incentives and budget-friendly alternatives that reduce waste. Businesses can leverage their success stories, using case studies for legitimate marketing content.

Major players including Marks & Spencer, John Lewis, Selfridges and Zara have either announced or rolled out resale or rental services over recent months. When executed credibly, such offerings allow businesses to diversify into complementary markets, appealing to a new wave of sustainable shoppers.

Accessing green finance

All major UK banks are potentially looking to increase their green and sustainable financing, aligning lending strategies to the UK Government's 2050 net-zero commitments through membership of the global Net Zero Banking Alliance.

Financial institutions have already deployed ESG standards and frameworks to identify investment opportunities in green assets, as capital providers search for bankable projects that are aligned to their own ESG targets and net-zero commitments.

Access to such finance will be critical for some retail and hospitality businesses to pivot their operations to net zero, making the substantial upfront cost to implement renewable energy, energy efficiency and green buildings more manageable. For landlords, leisure businesses and retailers with large commercial real estates, access to affordable finance will be essential to protect the viability of operating complex portfolios.

Capital requirements will mean that ESG goals and reporting on progress will become an expectation of investors, requiring visibility across the value chain in order to assess ESG impact.

Contents

Section three: Strategies to survive and thrive in 2023.

5. Leveraging data and AI.

Predictive analytics

Using AI to leverage the value of customer data will become essential during 2023 as more businesses form strategic partnerships with tech companies to help complete in a volatile marketplace. Improving efficiencies, cutting costs and reducing waste in multiple operational areas could be the decisive factor in survival.

In particular, predictive analytics can be used to create more accurate sales forecasts, enabling improved inventory management, optimised stock ordering processes and preventing overstocking or stock shortages. For example, Tesco and Sainsbury's both use AI-powered cameras in their stores to track inventory levels and automate the process of identifying and removing expired products from shelves.

AI will also be used to optimise supply chains and logistics, which in turn will help retailers improve delivery speeds and reduce inventory carrying costs.

Personalisation

AI-powered personalisation will help brands boost their return on marketing spend in 2023. By utilising customer data sets, machine learning algorithms can be used to analyse customer behaviour and preferences to create highly targeted marketing campaigns, improve customer engagement and create more effective pricing and promotion strategies.

In the context of the cost-of-living crisis, empathetic communication can be adapted to suit relevant cohorts of customers based on previous spending data.

Contents

Section three: Strategies to survive and thrive in 2023.

Chatbots

As AI language algorithms become ever more sophisticated, the uptake of chatbots used within the customer journey (eg customer service and sales) is likely to see an uptick. Not only can this help improve the speed and accuracy of customer service, but it can also reduce the cost of customer support. Retailers such as ASOS actively use AI-powered chatbots on their websites to assist customer queries, for example.

The launch of ChatGPT, a chatbot launched in November 2022 by OpenAI, is likely to give consumers an awareness of the application of AI and potential disruption that hasn't been present until now. Consumer adoption is likely to be extremely rapid, which will open the path to significant disruption in the consumer space.

Conclusion

Let's not sugar-coat it – 2023 will be an exceptionally challenging year for many retail, leisure and hospitality businesses. But with disruption and shocks to consumer behaviour comes opportunity. Those pivoting their proposition to align with these emerging customer values – commonly centred on value – will be better placed to weather a potential recession.

Against the backdrop of these challenges, businesses will have to prioritise cost cutting and profitability as margins come under intense pressure. A delicate tightrope to walk – balancing cost reductions with a compelling customer experience that can secure existing customers, win new ones and remain relevant.

As efficient operating models become increasingly reliant on data and digital strategies, winners will be those that can effectively leverage data science, either in-house or from strategic partnerships. Furthermore, strong balance sheets often win through during consumer downturns. The same is likely to be true during any recession.

The year will also be characterised by further consolidation (particularly in the mid-market), direct-to-consumer brand acceleration, partnerships (eg 3PL), multichannel players leveraging their competitive advantage, retail media growth and a further rebalancing of online towards in-store.

Throughout 2023, there are likely to be more retail and hospitality casualties, but as the economy emerges from recessionary events, so too will a more resilient consumer industry.

"As the economy emerges from recessionary events, so will a more resilient consumer industry."

Contents

About Retail Economics

Retail Economics is an independent economics research consultancy focused on the consumer and retail industry. We analyse the complex retail economic landscape and draw out actionable insight for our clients. Leveraging our own proprietary retail data and applying rigorous economic analysis, we transform information into points of action.

Our service provides unbiased research and analysis on the key economic and social drivers behind the retail sector, helping to inform critical business decisions and giving you a competitive edge through deeper insights.

Retailers will face tough challenges throughout 2023 as softer consumer demand collides with a tougher trading environment. This report focuses on the major headwinds facing the industry and what successful businesses are doing to navigate these choppy waters.

We're delighted to be partnering with NatWest to produce our outlook report for the retail, hospitality and leisure sector. As the retail landscape constantly evolves, retailer brands must be prepared to adapt to changes and embrace new technologies to stay ahead of the competition. Those that understand and respond appropriately to developments within the industry will be better positioned to weather further disruption and drive growth.

Richard Lim
CEO, Retail Economics

Contents

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Contents

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